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

The Markets

If you look back at 2017 and recall what we have been dealing with – concerns over the Brexit negotiations, the continuing crisis in the Middle East, US interest rate hikes, President Trump's crazy tweeting and his protectionist tendencies, a sabre-rattling North Korean dictator and largely indecisive election results in the UK and elsewhere – you would be forgiven for thinking that major stock markets last year had to be recording mainly negative performance.

Not so!

A cursory glance at a broad range of stock market indices would lead one to the conclusion that 2017 had been a very good year for investors. In America, the Dow Jones rose by 25%, the Japanese Nikkei by 19% and the Morgan Stanley BRIC index (Brazil, Russia, India and China) by almost 39%. The figures for the UK and Europe were a little more modest (in high single digits) but, even here, records were broken as investors continued to push markets ever higher.

Of course, no one invested on 31st December 2016 and sold on 29th December 2017. The broad-brush figures merely give an indication of the direction of travel and hide the daily ups and downs, both in terms of sentiment and market performance. For example, an investor who entered the UK market in April would have achieved slightly better growth than those who joined at the start of the year whereas latecomers who invested in August would have achieved less than 2% by year end. It is all a matter of timing, as we have repeatedly cautioned.

The caveat to this is that without the benefit of hindsight, it is impossible to know where the optimum entry and exit points might lie and it remains true that not being invested during the best ten days will have a significantly detrimental effect on overall returns. Provided investors heed advice regarding the provision of a deposit-based emergency fund before entering the market, conditions such as were experienced in 2017 are worthy of participation despite the regular bouts of volatility and occasional downward price moves.

At the heart of the steady market gains lies the sound economic conditions in three of the world's major economies – the US, Japan and China. Such co-ordinated growth has been rare since the financial crisis and, spurred on by extremely low interest rates and the poor level of returns on cash deposits, investors remain drawn towards 'risk assets' such as equities which appear to offer better returns. The optimistic view is that a bull market does not "die of old age" but requires a change in fundamentals. Whilst a correction based on declining economic conditions will undoubtedly come, there appear to be few obvious signs of this in the near term.

If anything gives us cause for concern, it would be the almost complacent dismissal of "bad news days" as reflected in the S&P volatility index ('VIX') which has virtually flat-lined despite the very real geopolitical dangers in the Korean peninsula and the Middle East. Had these news events occurred when market sentiment was less buoyant, the effects would have been much more pronounced.

Declining economic conditions typically throw off early warning signals and can take several weeks or even months to come to fruition whereas a switch in investor sentiment can be almost instantaneous and lead to significant drops in short order – witness the 340-point fall on the Dow index in a matter of hours after former National Security Advisor Michael Flynn made potentially damaging comments about relations with Russia during the presidential election campaign. There is little defence against such unforeseen events.

Complacency leading to investors becoming overstretched is a dangerous thing and, whilst we have continued to participate in the positive market conditions, we have also trimmed profits and moved to areas of the market where we feel there is less risk when conditions appeared a little too tense for comfort. Monitoring of economic trends and the positioning of portfolios to cope with the worst impact of the unforeseen remains the best approach in our view, whilst the holding of some cash as a safety net is an absolutely essential prerequisite.

As far as strategic changes to portfolios are concerned, we reduced our exposure to the UK in the last quarter of 2017. We were nervous about the questionable progress in the Brexit negotiations, low productivity and poor real wage growth leading to an income squeeze and lower consumer spending against a backdrop of ballooning consumer debt. Did we do the right thing by reducing UK exposure? Well, this Wednesday an article in the Financial Times would suggest we did. The piece stated that a net 36% of global fund managers were underweight in UK equities, and another global fund management group, looking after some £65 billion in assets, said that right now, they were not in UK stocks.

In November, the OECD gave the UK a pretty damning GDP growth forecast, citing some of the above and adding inflation worries as a result of the falling pound. Their view was shared by Swiss bank UBS and US bank Morgan Stanley, the latter taking an even more pessimistic view by predicting GDP growth of 0.8% for 2019. We have always taken OECD forecasts with a pinch of salt – remember their warnings before the EU referendum that a "leave" vote would result in an immediate and severe shock to the UK economy? As to Morgan Stanley's forecast, we think forecasting the *2019* UK economy in November *2017* had to be based on a lot of guesswork.

Let us just briefly look at the consequences of a lower pound: yes, as a net importer of goods and services, UK imports will be more expensive, and that does have an impact on inflation. Anyone going abroad on holidays will also encounter higher costs. Inflation has crept up since the Brexit vote, but it has now reversed that trend by falling from 3.1% in November to 3% in December. We are told this is due to cheaper airfares, toys and games, and the Bank of England expects the inflation rate to fall back to 2.4% by the end of this year.

On the other hand, a lower pound helps exporters, as UK goods and services become cheaper for overseas buyers and will increase foreign demand. Another sector, often overlooked, is the online business community that can adapt websites to allow foreign buyers to pay in their own currencies. According to PayPal, the second half of 2016 saw a 34% rise in overseas sales. Finally, there is tourism, and the UK has seen an increase in EU and other countries' visitors, coupled with the fact that many UK holidaymakers choose to stay here rather than go abroad.

Brexit

Last week, our Chancellor Philip Hammond and Brexit Secretary David Davis went on a charm offensive by visiting Berlin and Munich in an effort to overcome staunch German opposition to what Britain is calling "managed divergence" from the EU. Angela Merkel has declared that Britain cannot "have its cake and eat it", and Monsieur Barnier has used another British metaphor by telling us that we cannot "cherry-pick" the deal we want.

The EU's 27 remaining member states will now engage in intensive debates in order to reach agreement on how to tackle the second round of Brexit talks, which will address trade and other parts of the future relationship between Britain and the EU. The Brussels chiefs have said that they would arrive at a "mandate" by the beginning of March, and they envisage that mandate to be consensual and undivided. "EU unanimity" in this instance strikes us as something of a misnomer, bearing in mind that Euroscepticism to varying degrees is beginning to make itself felt in many different member states. It is also worth remembering that the EU last month instigated legal action by taking three of its member states, Poland, the Czech Republic and Hungary, to court over their refusal to take their respective quotas of refugees, quotas that had been imposed on them by Brussels back in 2015. The court in question, of course, is the European Court of Justice, and the three affected member states will soon find out what they have signed up to.

From what we hear, some core EU countries, as well as some Nordics and East Europeans, take a fairly pragmatic view about the future cooperation and trade relationship between Britain and EU states, but that view clearly is anything but shared by both Germany and France.

Surprising, really, that Frau Merkel finds the time to actively oppose what Britain seeks to achieve, bearing in mind that she has been extremely busy trying to cobble together another coalition with Germany's social democrats. Her first attempt failed, which was not surprising as both Chancellor Merkel's own Christian Democrat party (CDU) and the socialists (SPD), her previous partners in the so-called Grand Coalition, recorded their worst election results since the second world war.

The SPD, similar to the UK's Lib Dems after their coalition with the Tories, did not have the appetite to repeat the exercise. Needless to say, neither party was willing to engage in any way with the nationalist AfD (Alternative für Deutschland) who recorded 13% of the vote and managed to get a far-right party into the Bundestag for the first time in six decades.

Angela Merkel then tried to form what is known as the "Jamaica coalition", so named after the colours of the Jamaican flag: black (the conservative CDU), yellow (the liberal FDP) and the Greens. That attempt also failed, and she has again tried to woo the socialists back into coalition. Only last Saturday, it appeared that she was succeeding when she talked of a "new dawn" after apparently reaching agreement with the SDP. Alas, she spoke too soon as, since then, all sort of opposition has emerged in both party camps. At the time of writing we are still no nearer a solution, and the SPD will vote on Sunday whether they will play their part in a coalition. If they cannot agree, Frau Merkel will either have to form a minority government or Germany will have to go to the polls once more.

There was quite a bit of Schadenfreude in Germany and elsewhere in the EU after Theresa May failed to increase her majority in the UK elections in June, and one can only wonder what her then Continental critics now think!

France, the other main opponent to Britain's "managed divergence", is not without its own problems. Monsieur Macron will only be too aware that half the French electorate voted for Eurosceptic alternatives. His reform policies regarding labour laws and public-sector workers, as well as yet higher taxes for the wealthy, have resulted in nationwide strikes and huge demonstrations in Paris and other major cities. Unemployment in France is still running at just below 10%, and Macron's popularity took a nosedive. At the four-month mark after his election, he was described as the least popular president ever, but his approval ratings have improved a bit latterly.

In Italy, we have another "interesting" general election coming up. At present, the 5 Star Movement is slightly ahead in the polls. Founded by the comedian and political activist Beppe Grillo, it is difficult to give the party a label in traditional political terms. The 5 Star Movement, now under different leadership, is a populist, anti-establishment, anti-globalism and somewhat green political movement, and it is definitely Eurosceptic. Its main opposition in the forthcoming election comes from the centre-left Democratic Party led by former premier Matteo Renzi and the centre-right Forza Italia of Silvio Berlusconi. Yes, the old rogue is back in the frame!

The outcome of the election is impossible to predict, as is the length of the next government's tenure. Since 1946, when Italy became a republic, we have seen well over 60 different governments, and a friend of the writer refuses to go on holidays in Italy for fear that he might be asked to form a new government…

In essence, there currently is a lot of political uncertainty and dissent within the ranks of the 27 remaining EU member states, and we can anticipate an even bigger quarrel by May of this year when the EU will have to agree on a new budget for the seven years after 2020, i.e. *after* the UK has departed, leaving a hole in EU finances estimated at over 10 billion euros.

Earlier this month European Commission president Jean-Claude Juncker called for bigger contributions from the EU-27, not surprising given higher planned expenditure for security, migration and defence. In addition, both Germany and France are pushing for further integration which, of course, also comes at a cost. Monsieur Juncker stated that the UK's contribution shortfall should not come at the expense of cutting expenditure in areas such as the Cohesion Funds (intended to help poorer regions within the EU) and the Common Agricultural Policy, which together make up more than 50% of the overall budget. We have heard of a plan that would very much affect the poorer regions, and we will find out how good our information channel is. Monsieur Juncker said this: "I am not in favour of drastic cuts in the cohesion policy sector." We will learn what he means by "drastic". He also added that financial discipline should not become loose. That is a bit rich coming from the president of an organisation that has failed to get its accounts signed off for donkey's years!

President Trump

If only a quarter of the accusations in Michael Wolff's recently published book about the President and the White House were true, you would think that we had a mentally deranged leader of the free world as its occupant with an administration to match.

We all have heard and read endless accounts in the media about President Trump's persona, his entourage and political advisers. Of course, we know that he has few friends in the media, and according to their reports he does seem to be the possessor of a rather warped mind.

Donald Trump always divided opinion, be that before, during or after his campaign. His victory came as a shock and he was derided by many world leaders. Since his inauguration, his popularity, what little there was, has waned, with 54% of Americans now disapproving of their leader. However, a Panorama programme earlier this week suggested that his voter base has largely stayed intact.

Leaving all that to one side, what have been his achievements in the first year in office? Well, it has been far better than anyone could have predicted. Irrespective of how you see the man or his policies, he has accomplished quite a few of his campaign pledges, the biggest being a massive tax cut (reckoned to equate to a staggering $1.5 trillion over ten years) by reducing corporation tax from 35% to 21%, allowing companies to fully write off new buildings and equipment and introducing a "territorial tax system" which allows companies to pay tax on US based operations only. Under his watch, US stock markets have scaled new heights and confidence in the economy is strong.

Trump has also managed to repeal a number of laws and regulations introduced by his predecessor Obama, resulting in less governmental supervision, withdrawal from the Paris climate accord and the Trans-Pacific Partnership. He introduced a (watered-down) travel ban and managed to get his nomination into the Supreme Court, ending a long and bitter dispute. Abroad, he successfully fought ISIS and ruffled more than a few feathers by declaring Jerusalem the capital of Israel.

Looking ahead, we think the global economy will continue to slowly improve with markets registering low single-digit increases, but too much depends on investor sentiment, so watch out for a "black swan" event!

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