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Keeping you informed matters

Economic review

July 2019

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Outlook

World equity markets rose during the quarter. However, that relative stability in equity markets belies a much more complex and volatile geo-political picture, rather like a swan gliding over a lake with vigorously paddling feet hidden from view.

The world economy is beginning to show signs that the ongoing trade disputes Trump has engineered are now slowing global economic momentum. We may be seeing the early stages of the dismantling of the post-war trading arrangements, in the General Agreement on Tariffs and Trade (GATT) and the World Trade Organisation, that have governed world trade in the post-war period. This raises risks for global growth and financial risks for investors.

Most leading indicators point to slowing momentum in the world economy. It now looks like the peak in the current expansion for the “rich” nations of the Organisation for Economic Cooperation and Development (OECD) was 2017. For Japan and Europe, growth rates in 2020 could be 50% lower than those recorded in 2017. Even the US is likely to see real GDP growth falling from 2.8% in 2017 to 2.2% in 2020.

The US forecast is particularly interesting because it is below the 4% growth rate targeted by Trump and this is the cause of his increasingly bitter dispute with the Federal Reserve which he accuses of doing an “insanely” bad job. It is hard to believe that Jerome Powell, the Chair of the Federal Reserve, was Trump’s nominee. The key takeaway from this spat is that policy is likely to err on the “stimulative” side. Inflation remains low, so there is no current monetary impediment to low interest rates, but the contradictory nature of this trade policy is that it raises consumer prices.

Contrary to Trump’s beliefs, exporting nations don’t pay tariffs, consumers do via higher prices. This puts the Fed in a very difficult position: he wants looser fiscal policy particularly in the run-up to November 2020 (his re-election year) however, the Fed needs to maintain stable prices and, equally importantly for policymakers and investors, preserve credibility and independence.

Elsewhere, growth bright spots include India and Brazil but Chinese growth is still slowing and is estimated to level out at 6%; higher than the developed world but far lower than the growth achieved previously.

Overall in their most recent Outlook, the OECD estimates that world growth will be around 3% for the foreseeable future.

The British economy has been helped by the depreciation of sterling which is something of a safety valve for UK companies. However, in a world of restricted trade, currency devaluations will be less helpful as both tariff and non-tariff barriers will conspire to reduce growth. So far, there has been little impact on inflation but since employment is at a record high, we would expect to see some upward pressure on inflation as both labour and goods become relatively scarcer post a disruptive “no-deal” Brexit, if that happens.

House price inflation has cooled significantly led by declines in London. Consumer confidence is closely linked to house price inflation and significant declines in property prices outside the capital would damage spending and expose highly leveraged individuals alongside damage to the domestic economy.

UK employment is at a record high and since the lows of 2009, nominal wage growth has been accelerating although the most recent figures suggested some softening. Surprisingly, retail sales have helped with a sharp recovery in volumes evident in Q1. Business investment also ticked up towards the end of 2018 and early 2019.

Given the underlying strength of the economy any cessation of the endless uncertainty over Brexit would likely result in a continuation of this welcome rebound in activity. Thus, there are some upside risks to the UK economy, if and when, Brexit uncertainty subsides.

Ultimately our new Prime Minister must find a way of squaring the Brexit circle with Parliament for there to be any positivity around the UK economy.

Key facts about the world

United Kingdom

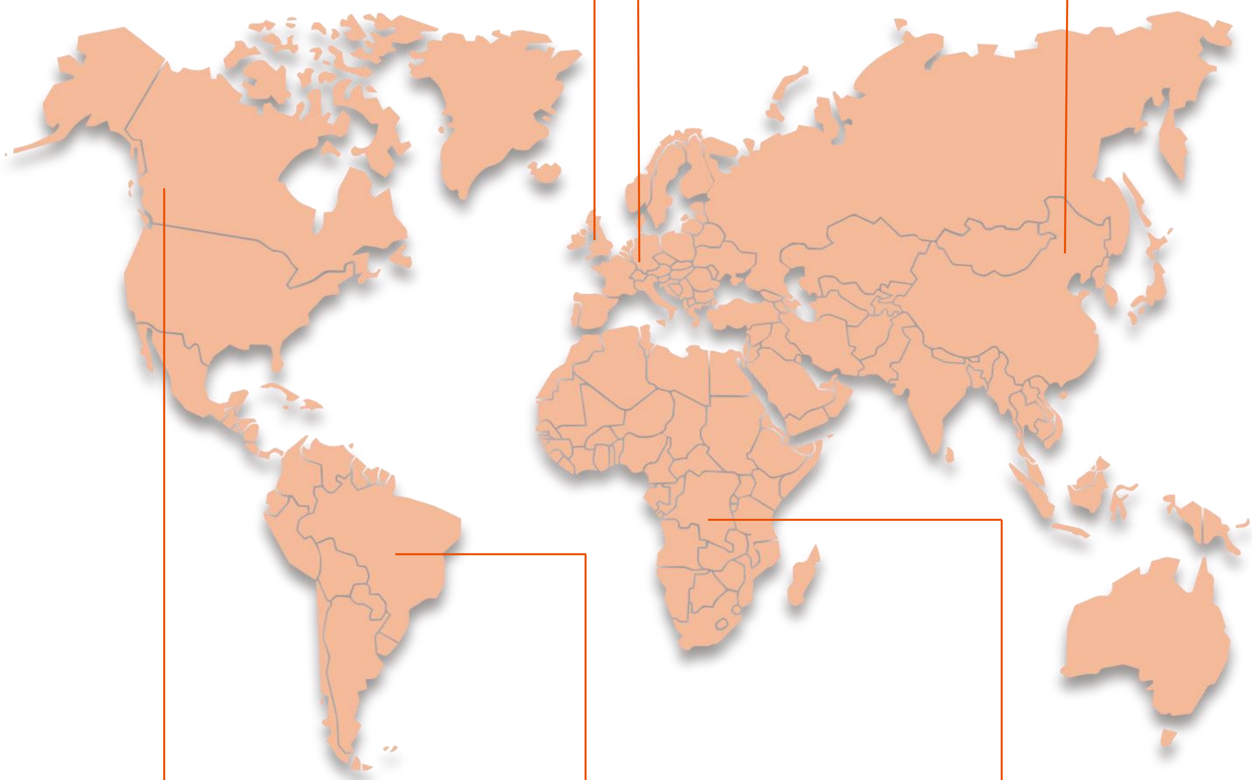
- Brexit continues to drive sentiment
- Sterling has fallen to three year lows
- The probability of an early general election has increased

Europe

- The Italian government is pushing the budget boundaries
- New head of the ECB is likely to be dovish
- Continued weak economic data remains a threat to the Euro

Asia

- China is playing the long game with the US over tariffs
- Hong Kong protests are another sign of the rise of populism
- Unexpectedly, Indian elections won by BJP convincingly



North America

- US economic growth remains robust
- New trade deal with Mexico is actually very similar to the previous agreements
- Presidential election cycle has begun

South America

- Brazil continues to flirt with recession
- If successful, the pension reforms in Brazil could transform the economy
- The region continues to be plagued by corruption scandals

Middle East & Africa

- US tensions with Iran continue to rise
- The less stable political situation has led to higher oil prices
- African economies are flirting with recessions again this year

Q2 Performance Review

Solid performance from equities

- The Pound fell against most major currencies
- Fixed interest and equity prices rose in tandem
- US equities continued to perform better than most other markets
- Unusually, certain UK equity holdings rose whilst others fell over the quarter
- Property prices stabilised after a period of poor performance

US and Financial equities lead returns

Global equity markets continued to rise in the second quarter with weakness in the Pound boosting returns for overseas holdings. Our position in US equities and Financials particularly helped performance over the period.

The best performing overseas funds during the quarter were again the Jupiter Financial Opportunities fund, Loomis Sayles US Equity Leaders and the JP Morgan Emerging Markets fund returning 10.5%, 9.5% and 8.4% respectively. Unlike in the previous quarter, there was no clear market theme driving returns although falling government bond yields did lead to a broad rise in equity prices as investors anticipated further interest rate cuts in Europe and now the US.

In the UK, Finsbury Growth & Income significantly outperformed the broader UK market, returning 10.7%. The dispersion in the performance of UK equities was very wide with the JOHCM UK Equity Income fund actually falling by 2.2%. This illustrates the divergence in pricing of those UK companies that have international revenues against those that are more domestically focussed.

Our fixed interest exposure has also provided positive returns as bond yields fell and prices rose. The best performer in this period was the M&G Corporate Bond fund which rose by 2.7%. It is also worth noting that the BMO Commercial Property Trust provided positive returns following a period when UK commercial property prices fell.

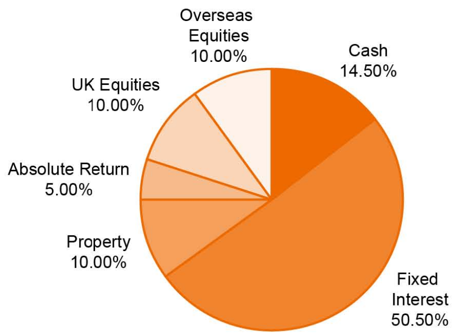
The key laggards were the Invesco Japan fund and the Merian Global Equity Absolute Return fund, both of which fell marginally. This is not unusual during a period when government bond yields fell and we continue to believe these holdings will provide positive returns in the future.

SECTOR	3 months	1 year to 30/06/19	1 year to 30/06/18	1 year to 30/06/17	1 year to 30/06/16	1 year to 30/06/15	5 years (annualised)
IA OE Europe Excluding UK	8.57	4.01	5.21	29.16	3.31	3.33	8.58
IA OE North America	6.89	14.75	14.00	23.33	12.49	11.41	15.12
IA OE Property Other	5.38	7.83	9.63	6.91	5.70		7.51
IA OE UK Small Companies	4.65	9.80	-5.67	36.60	16.86	-6.17	9.18
IA OE Emerging Markets	4.51	1.38	5.38	27.00	4.07	6.06	8.41
IA OE Asia Pacific Ex Japan	3.98	8.98	5.98	28.57	7.42	4.34	10.73
IA OE UK All Companies	3.75	7.04	-3.66	22.43	9.23	-2.18	6.17
IA OE Japan	3.74	17.16	7.97	24.88	10.74	-3.39	11.07
IA OE £ Corporate Bond	2.35	4.92	6.69	6.79	0.65	5.56	4.90
IA OE £ High Yield	2.22	-0.12	1.89	10.85	0.81	5.16	3.64
IA OE UK Index Linked Gilts	2.02	12.88	15.32	6.80	1.88	8.99	9.08
IA OE UK Equity Income	1.91	7.46	-1.31	19.37	6.15	-2.55	5.54

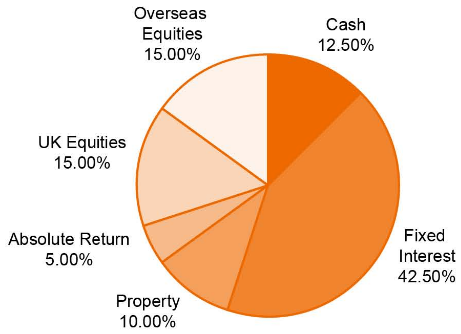
Source: Morningstar, bid-bid pricing. Net income reinvested. Past performance is not a reliable indicator of future results.

The positioning of our strategies

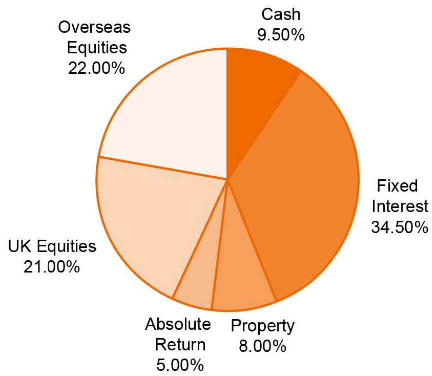
Very Conservative



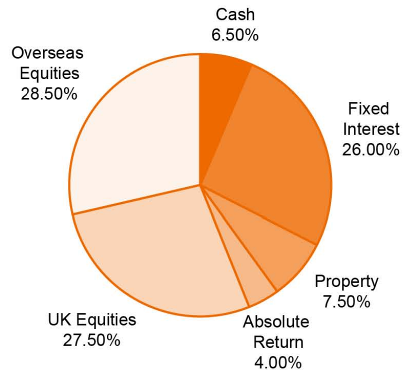
Conservative



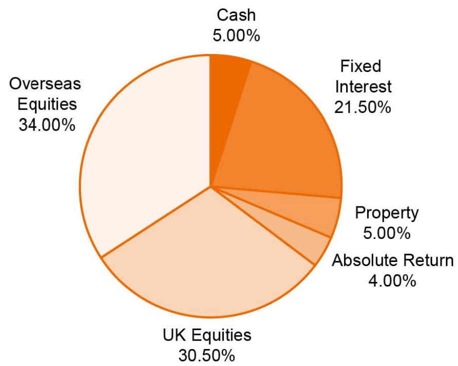
Cautious



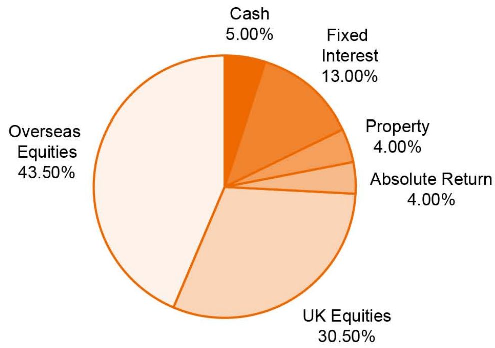
Balanced



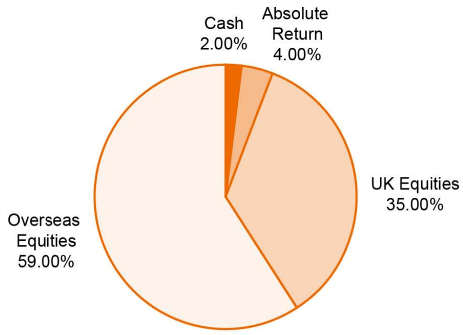
Growth



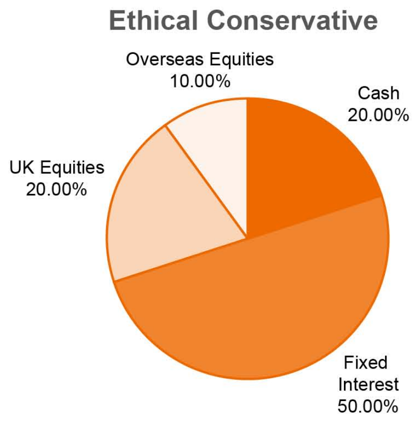
High Growth

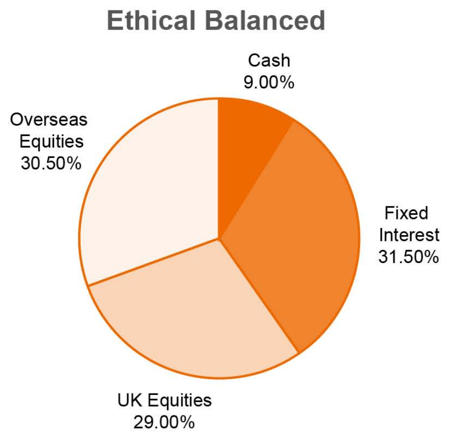


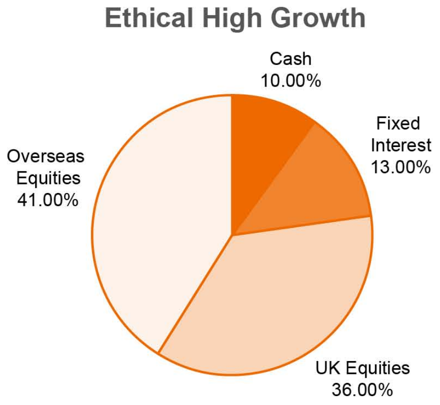
Adventurous



The positioning of our ethical strategies







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MM Wealth Ltd Wellbrook Court, Girton, Cambridge CB3 0NA 01223 233331 info@mmwealth.co.uk