June 2019
Portfolio Review

As we reach the halfway point of 2019, you could be forgiven for thinking we are back in January. We started the year following a poor fourth quarter with key issues for positive market conditions centred on a pause in the normalisation of interest rates by the Fed, resolution of the "Trump trade wars", clarity over European fiscal policy and…….Brexit. Any of these issues still sound familiar?

Taking these points in turn, there is enough weakness in the economic data and uncertainty in the outlook for the Fed to do more than pause, and even justify a cut. Core inflation as measured by the personal consumption expenditure deflator is soft. Indeed, the Fed is undertaking a review of its framework given the problem of consistently low inflation and it may be the Fed is now aiming for a period of higher inflation in the coming years. The market has now priced almost 3 cuts by year end, an extraordinary shift from the 2 hikes priced for 2019 last September.

And the Fed is certainly under considerable political pressure. The US president has explicitly stated (via Twitter) that the Fed is a deciding factor in whether the US "wins" the trade war. The natural assumption is that because the Fed is operationally independent, it is necessarily free of political interference. However, if a narrative builds that the Fed is not a "national champion", the public could start to question whether it deserves the powers afforded it. If the recovery falters, the Fed will not want to be the fall guy and the underlying problems from a fundamental perspective remain. Economic activity is slowing, and a real concern is that the market has got ahead of itself leaving it somewhat vulnerable to a sudden pull back.

In terms of president Trump, recent increase in US-China trade tensions pose a significant downside risk to economic outlook, however policymakers are likely to take measures to support growth. Indeed, the G20 last weekend provided some comfort to the traded goods sectors to end the current on-off stockpiling process. Clearly, most investors will be happier if Trump and Xi can deliver something soon but the ceasefire over further tariffs is a welcome start.

The Chinese economy does appear to have stabilised, though policy is inwardly focussed. At the start of the year, there was a concern that this policy would be ineffective, but it does seem that Trump's negotiating tactics have made Chinese policy more internally efficient. The ability to stem capital outflow has meant that liquidity has been targeted at the vulnerable smaller companies. The banks have become better at lending in this area, more ably displacing shadow-financing. Infrastructure spending has supported emerging market commodity producers without creating the boom-like conditions of 2017.

In Europe, a slowdown remains a worry. Trade wars are a concern with China being Europe's most important export market. However, on the plus side, wages are rising and governments are loosening the purse strings.

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Household spending drives around 70% of the US economy. It's a lesser share in Europe – more like 45-50% depending on the country – but that's still a very sizeable proportion. And, for the first time in around a decade, the European consumer is in a much better place. Some of this increase in wages can be attributed to minimum wage rises. Years of austerity after the global financial crisis are now finally coming to an end. As of April, the UK increased the minimum wage for over-25s by 4.9%. Spain's minimum wage jumped by 22% in January.

Meanwhile, inflation is relatively well-behaved (annualised inflation in the eurozone was 1.2% in May 2019). What this means is that consumers have more money in their pockets.

Further, the pressure applied by movements such as the "gilets jaunes" in France is having some effect. It's also reflected by the government in Italy, for example, where there has been the populist coalition rebellion against the EU's budget deficit limits. For the first time in a number of years, European governments are spending a little bit more and with governments making up between 40-50% of the average European economy, a boost of 0.5%, say, is a big stimulus if the economy in total is only growing by 1.0-1.5%. This could be very important in terms of internal demand accelerating in Europe.

As for Brexit, we appear to be in almost exactly the same place now as in December, with a deadline approaching and no discernible change in possible outcomes. The FTSE 100 and £-Sterling are pretty much the same level, with a slight depreciation versus the euro. However, it does appear that the new Prime Minister will provoke an outcome. That has the potential to provoke volatility especially in the currency in the next couple of months. An interesting aside is that the probability of an election this year has risen from 30% to 40% in the past few weeks.

Portfolios

June was a good month for investments with positive returns across all portfolios. Riskier portfolios rose approximately 2.3% gross with the most cautious rising 1%.

Strongest returns performance came from emerging markets funds as news of new trade deals eased pressure in those areas. The Fidelity fund lifted approximately 7% over the month. The US market continues to surge with the Vanguard fund rising over 4.5% and the larger weightings in areas such as UK Equities, which have the more significant influence generally across portfolios, rose between 1.5% for the index tracking funds and 2.0% for the top performing actively managed fund.