THE GLOBAL CIO OFFICE

Your Outsourced Investment Office Starts Here

The Global CIO Office is an outsourced Chief Investment Officer (CIO) services provider for single and multi-family offices, and wealth management businesses. We partner with clients to help build and manage their investment offering. We provide a wide range of specialist investment expertise in a cost-effective manner.

Our founding members **Gary Dugan** and **Johannes Jooste** are well known across the industry for their considerable experience and deep knowledge of investment platforms and investment processes. Our team is also comprised of industry experts such as CIO's, strategists, economists, due diligence and asset class experts with a strong track record.

Our independent advice and research are a key differentiator that sets us apart from other investment advisory firms. This document contains all of our weekly newsletters for Q4 2019.

The Global Outsourced CIO Industry

The **Outsourced Chief Investment Officer** (**OCIO**) industry has grown by over 860% in the last 11 years, proving to be a successful model in the U.S.

- Over the last 11 years, the volume of assets managed and under advice by OCIOs has increased by over 860%. The growth of the OCIO market seen in the U.S. is set to continue across the globe. According to data from Pensions & Investments' OCIO managers reported a 23% surge to $1.74 trillion in assets managed worldwide from 2017 to 2018.

The **OCIO model** benefits the Asian and Middle East wealth management industry by providing easy access to investment resources and specialist expertise in a flexible, cost effective manner.

- The OCIO model is suitable for the Asian and Middle East wealth management industry as the requirements of investment firms are similar. The flexible and cost-effective nature of OCIOs help wealth managers keep up with varying client and investment product demands. This helps alleviate the administrative burden and expenses associated with it.

- Given the increasing uncertainty and volatile economic climate, wealth management firms partner with OCIOs to benefit from trusted investment advice and flexible investment resources.

Management

Gary Dugan - Chief Executive Officer

An investment professional with 35+ years experience of buy and sell side of the banking businesses. He has managed numerous strongly performing investment and advisory teams in large banks in Europe and more recently in Asia and the Middle East. Gary built businesses from scratch and successfully restructured them. He has had links with Asia and particularly Singapore since 1999 when he managed money for the GIC, Hong Kong Jockey Club and Brunei government. The core of his career was the 11 years at JPMorgan where he made Managing Director. On the buy side he has worked for asset management firms (e.g. JPMorgan) and private banks (Barclays, Merrill Lynch, Coutts, Emirates NBD and NBAD). Gary has a reputation for making bold calls on the markets, having made major bear calls on equity markets in 1987, at the top of the tech boom and the financial crisis in August 2007, and a bull call on equity markets on March 17th 2009. He has a high profile with the media regularly appearing in the printed press and on TV, often speaks at conferences and provides industry thought leadership on a number of macro and investment topics. In the past he made a presentation to the European Parliament on the outlook for asset markets after the introduction of the euro. Gary is also highly regarded for his team leadership, the rigour and intellect he brings to the investment process, attention to governance and ethics, and affinity with clients in presentations and meetings. He was voted Private Banker of the year 2015 (MENA) from Wealth Briefing.

Johannes Jooste - Managing Director

Johan started his career in banking as a currency and interest rates analyst in Johannesburg in 1994. After stints trading currency and managing South African bond portfolios, he relocated to the UK in 2001, managing global fixed income portfolios for institutional clients before switching course and joining Merrill Lynch Private Wealth Management in 2008. In this role, which was subsumed into Julius Baer in 2014, Johan was successively entrusted with Fixed Income management (Merrill Lynch) and thereafter overall strategy as CIO: UK for the Julius Baer business. In 2016 Johan relocated to Singapore to take up the role of CIO at Bank of Singapore, before joining Purple Asset Management in 2019 as Managing Director.

OUR RESEARCH

- We are fully independent from product providers and hold no motivation for placing in-house products with our clients. Hence, clients can be assured that they are receiving unvarnished investment advice based on views gathered from our independent research.

- By possessing the required resources and expertise to conduct our own research, we can provide an unwavering and external opinion regarding what is most suitable for a client depending on their individual needs. We also provide periodic and thematic research services on behalf of our clients that can be white labelled.

- Our independent advice, research capabilities and breadth of experience enable us to further support clients in generating revenue. We provide the required resources, material and advice to help with their sales meetings and the overall positioning of products.

- The Global CIO Office publishes weekly newsletters which cover global topics on geopolitics, financial markets, economics and more.

Our weekly newsletters for Q4 2019:

December 23rd, 2019

Record Debt and a Rate Rise!

- **World Bank warns of the risks to the financial system from record debt**
- **In the same week the Swedish Riksbank raises rates**
- **Fortunately, few central banks look set to follow the Riksbank - for the moment**
- **Investors should stay cognisant of the risks to the stability of financial markets**
- **Meanwhile credit markets keep rallying**
- **We remind investors to keep an eye on the quality of their bond portfolios**

In a week when the World Bank was warning of the risk to the global economy from a record $55 trillion of debt, it was worrying to see a central bank raise its policy rate. The last thing the world needs at this juncture is higher interest rates. Fortunately, it appears that few any other major central banks are likely to follow the Swedish Riksbank quickly. But the world has been warned!

A new report from the World Bank highlighted the rapid pace of debt accumulation - the quickest in some 50 years. "The size, speed and breadth of the latest debt wave should concern us all," said World Bank President David Malpass. The report warns that there is a risk of another significant financial crisis, especially if interest rates spike or if there is a sudden global shock.

Riksbank: Hunting higher, not lower. In a surprise move last week, the central bank of Sweden (Riksbank) announced that it was increasing its repo rate from -0.25% to 0. Thus ended its experiment with negative interest rates. Some have hailed the decision as a brave break with current convention; it is certainly an interesting test case for others such as the ECB to observe. Elsewhere it was criticised as a premature move driven as much by public opinion as to the need of the domestic economy.

The Riksbank bank's accompanying statement does little to address the criticism that the economy was in no need of a monetary policy tightening. It points to the fact that the Swedish inflation has reached 2% and has held stable there for a while. The bank also states that it expects the policy rate to remain at zero "in the coming years". At the same time, it will continue with its quantitative easing through purchases of Swedish government bonds worth a total amount of SEK 45 billion up to December 2020.

Apart from that, the statement errs on the side of brevity. There is little that the Riksbank says that suggests an economy heating up. Instead, they make mention of a new, lower forecast growth trajectory that the economy finds itself on -no inflation fears here. If anything, the Riksbank surely had reasons to keep the policy rate unchanged for some time to come; for example, recent labour market data has been weak. The bank also mentioned the need for financial stability – negative interest rates hurt bank profitability. Still, the argument here looks a bit tenuous unless there are lurking problems in the financial system that we do not know about.

Public opinion may have been a more significant driver of the rate hike. The policy is viewed as having a detrimental effect on domestic banks, as well as fuelling a debt-accumulation spree by Swedish consumers. The Riksbank has been on the defensive from various quarters in the past. The efficacy of NIRP has been questioned: did it have any particular effect on the economy, growth or employment?

Given the weak state of the eurozone economy it is quite clear to us that there is no reason to believe that the ECB will follow the Riksbank. In some areas of the eurozone, the idea of negative rates has never been popular, to put it mildly. Critics raise the same issues where banks and savers are seen to be disadvantaged unnecessarily.

Despite harsh words from some quarters, the ECB is unlikely to be swayed by the Riksbank abandonment of negative rates as a policy tool. The ECB introduced a tiering system recently that is aimed at mitigating some of the damage to banks from the running of negative rates. The ECB also views quite strongly that negative rates have been conducive to stimulating lending. Banks can't have it both ways. It is also sadly true that many other parts of the European economy can't risk hiking rates in the way the Riksbank can: growth is still feeble and possibly won't survive a rate hike.

Credit rally of the year: You never can tell! What a difference twelve months have made. Just when it seemed that the credit market rally of 2019 had run out of steam a month early, December came along and provided one last hurrah. Last year, around this time, credit markets were going into a spasm of illiquidity and near panic. Credit spreads over government bonds were as high as they had been since the start of 2016 and rising fast. This year, Christmas is a lot kinder to credit investors. Global high yield returns for the December are at 2%. In the US, the month-to-date return is 1.8%; in Emerging Markets, the gain stands at 2.5%. These numbers will take 2019 from good to great in the statistics for total returns from credit.

At the same time as credit spreads have been rallying in synch, treasury yields have been rising. So not only has credit put in a barnstorming finale, it has done so at a time when government bonds have been losing ground. US high yield spreads have dropped from 327 basis points at the start of the month to 284 now. The level below 300 basis points has only been reached on two other occasions since 2014. With treasury yields rising on the month, the loss from holding them would have been around 20 basis points on average, with slightly worse outcomes for longer-dated maturities.

In addition to the risk-on sentiment prevailing in financial markets at the moment, there is one other factor that may be a differentiator this year compared to last: the Fed's "QE4" and bigger involvement in the repo market. The end of 2018 was purported to be the first instalment of the drying up of the US repo market; the second instalment happened later in the year. From all reports, the odds of another dry spell in the repo market have been slashed with the Fed stepping in to provide the liquidity required.

Considering the recent views from the rating agencies and other analysts that default rates will be stable to higher in 2020 compared to 2019, the investment outlook for credit has become a bit more challenging. With the handle on the overall index yield now at 5% and not 6% as at the end of November, selectivity is going to be even more critical next year. The overall default level should indeed drift closer to 4% for high yield globally. Taking a rough guess that the average loss when a bond defaults is 50%, that implies a "loss budget", on average, of 2% per annum. That leaves somewhere between 3% to 4% on the table for a credit investor, assuming rates stay stable.

THE GLOBAL CIO OFFICE

December 16th, 2019

A Lifting of Clouds

- **UK Election removes some uncertainty over Brexit, domestically focused stocks to do well**
- **A seeming trade truce brings respite for the markets**
- **Credit markets remain a good risk-on play, but buyers need to pay attention to the details**

Brexit recap: Back to business

After three years of plodding around, there is finally a very real chance that the UK will begin to make progress in exiting the EU. The new government ran on that platform in last week's election and was given a clear mandate to proceed. If nothing else, the thumping size of the victory should allow the fog of uncertainty to clear and provide a confidence boost to UK assets.

As we mentioned briefly before, the surge in GBP on the back of the results is not an unalloyed boon for UK equities. The larger-cap stocks have significant global earnings exposure that will not be helped by a surge in the currency. However, the more domestically-focused FTSE-250 has a shot at outperformance now, given (a) it has lagged other indices for a significant period and (b) there could be a rebound in the domestic economy where global exposure is less pronounced and the strong currency will not be a performance headwind.

We don't read the situation as a "clean" win for the idea of Brexit: there is still a huge amount of details to be negotiated. It will help that the EU no has to view the Tory government as having a mandate. It should also be the case that parliamentary delays will be limited. That does not mean the exit process will be quick or easy. But the election mandate does mean there will be less procrastination.

A trade truce for Christmas

Another of the geopolitical risks overhanging markets, the trade war between the US and China, looks to be easing a little bit, or maybe a lot. Within the next few weeks critics and supporters alike will have a chance to study the 86 pages of the "phase one" agreement between the US and China. It is touted to have details on an agreement for China to buy more agricultural products from the USA, include commitments on respecting intellectual property rights, and also have provisions for actual enforcement in the event of non-compliance.

On the face of it, the deal looks to be quite US-friendly in the first instance. However, details will only be forthcoming later. Furthermore, it is by no means decided just how many phases the whole process is likely to have. With phase one taking the thick end of a whole year, expect the trade issue to dominate policy discussion between the US and China for years to come. For the immediate future, there may be a respite in the form of the US presidential election. For the longer term, the broader issue of global technological dominance will continue to cast a shadow over any future tariff talks.

Global growth in Q1: was Q4 2019 the low?

With the two big political developments mentioned above reducing some of the tail risks that markets were facing, the question now becomes whether or not we will see a return of economic growth at the stronger pace of the first of 2019, compared to the sluggish pace recorded running into the year-end. Some of the numbers do not make for encouraging reading. By some measures of global output, manufacturing ended 2019 roughly flat – showing no expansion – and retail sales, as well as automobile production, recorded nasty declines. For a more optimistic prognosis, these developments have to stabilise and reverse.

The recent developments are indeed a good thing not just for markets but for the global economy as a whole. Trade wars have no winners, just bigger and smaller losers. A truce, however temporary, reduces the scope for losses on either side. More directly, a truce will remove one of the blockages that may have prevented Chinese policy actions from having their desired stimulatory effect. GDP growth in China dropped to 5.5% in the final quarter; as credit expansion remains on track growth could rebound to 6% early in 2020.

Central Banks on hold

There has been some talk about inflation returning to the system, and that investors should begin to take the risk of an inflation surge more seriously. It is never a bad idea to be cognizant of risks, but this one looks a bit remote at the moment. True, there has been a surge in food prices in some countries, driven by local factors, but the overall picture looks benign.

The Fed is no hurry to re-open the debate about inflation risk, and nor is the ECB. Both are fully on hold or possibly easing. The Fed has made it as clear as it dares that only a sustained rise in the inflation rate above 2% per annum will make it reconsider its current stance. The ECB will also be in no hurry to proceed upwards, and may even be distracted by the change in tone from the top, where the new President Ms Lagarde has weighed in on topics ranging from climate change to fiscal policy.

Credit market takes its cue from stocks, up to a point

The topic of the health of the credit market should demand investor's attention in 2020. As is typical at the end of a prolonged economic upcycle, credit metrics in some markets will begin to show strains. These could be in the form of credit quality, funding scarcity, or increasing default rates.

In a recent update on the state of the global credit market, Moody's points out that default rates through the end of the year (US High Yield) to be running in the region of 4%. This is higher than the 3% at the beginning of the year, but it is stable around this level, which is also quite close to normal for non-recessionary periods. Recessions are typically witness to big spikes in default rates. A number of this magnitude is an important factor when investing in high yield: always have a buffer to account for defaults.

Higher up on the credit spectrum, concerns will focus on the health of the BBB sector.

In the same report, Moody's points out that the strength of the equity market has been a factor that has mitigated some potential downward rating migration risk in this bucket. Based purely on underlying credit fundamentals, it could be expected that more bonds would be at risk from becoming fallen angels, the term for BBB bonds dropping to BB. This has not fully been the case in 2019, given that strong (arguably overvalued) equity market levels has enabled many firms to engage in balance management to mitigate the probability of credit downgrades.

December 2nd, 2019

Drifting to the Left

- **November sees muted returns from most asset classes**
- **Watch for more left-wing drift of global politics – Germany the latest example**
- **The US 'gives thanks' with good levels of retail spending**
- **Japanese consumers don't spend but the government will – positive for equities**
- **Asian economy shows improvement and international investors fund China**
- **Climate change a focus of central bankers**

Financial markets are drifting-into the year end. Investors look like they will have to wait until the new year before we see the next phase of government and central bank stimulus to boost growth. Over the past two months global economic activity has been on the softer side of consensus forecasts but not sufficiently so to unnerve investors.

November has closed out with some modest gains for equity markets and close to zero returns on government bonds and higher-quality credit. By sector technology (+3.9%) and healthcare (+4.3%) stocks have led the way in global equity markets. The US (+2.4%) and India (+1.6%) led gains in the developed (+1.8%) and emerging markets (-0.9%), respectively.

European politics shows signs of moving to the left

One of our themes for the next decade is that of a likely swing in political thought to the left. Income and wealth inequality are likely to make left-wing policies more attractive to the voting populations the longer that incumbent governments don't address the issues.

Hence evidence of a shift to the left by one of Germany's major political parties is noteworthy. The SPD's new leadership of the Walter-Borjans and Esken are said to favour taxing the rich, boosting welfare spending and abandoning Germany's balanced budget. There are fears that they will leave the CDU-SPD coalition that currently leads the government.

Left wing politics is also very evident in the UK. Many in the UK would like to wish away the chances of Jeremy Corbyn led Labour party ever getting into government however opinion polls have swung to some degree in his favour in the past week. The Labour party advocates wholesale tax increases on the rich and those with non-domicile status. A Labour government would raise corporate taxes. Even with the taxes raised, the government would need to borrow heavily from the markets given aggregate sending plans of £833 billion that equate to around 30% of GDP! **If it were ever to come to pass that the Labour party were able to enact any of these policies, UK gilts and equities could suffer significant losses.**

It's easier to look at political developments in Germany with a more favourable eye. The new SPD leadership are only pressing for changes that might be more broadly welcomed across Europe. For some time, many economists have argued that Germany should help support both domestic and pan-European growth through some fiscal expansion. Germany's economy has approached recession-like conditions in recent quarters. The spending focus of the SPD measures is to combat climate change and education.

At this stage, political developments in Germany look more palatable to the markets than a Labour-led government in the UK. We doubt that the SPD will abruptly leave the CDU-SPD coalition. In any case, the SPD's position on spending at least opens a broader discussion about an increased level of support for the German and eurozone economies from German government spending.

US on-line retail spending appeared alive and well through the first part of the holiday weekend, although slightly below expectations. According to Adobe Analytics, consumers spent $7.4 billion online, up $1.2 billion on Black Friday 2018. Thanksgiving transactions broke records with $4.2 billion in online sales. Adobe tracks sales in real-time for 80 of the top 100 US retailers.

Japanese equities hoping for policy support

Judging by the weakness of economic data, you might be worried about Japanese equities. However, there is every sign the policymakers will come to the rescue. October's retail sales were down 14.1% as the imposition of a higher sales tax and the typhoon weighed on spending. The fall in retail sales was the worst in 10 years. Industrial production was also down 4.2% at an annualised rate month-on-month. The weak data leads to greater confidence that the government will react with a larger than expected fiscal easing in the new calendar year. The government will also be encouraged that despite the plunge in retail sales, consumer confidence is relatively upbeat. In November consumer sentiment rose 2.5 pts to an index level of 38.7 continuing the rise off the low of 35.6 in September.

We remain sympathetic to the view that Japanese equities could see some outperformance in 2020. The past twelve months have been poor with a capital return of 4.6% for the Nikkei. In 2020, we expect significant fiscal loosening and a further round of support from the Bank of Japan. The economy will also benefit from the spending and publicity from the Olympics and Paralympics. Quite frankly, there is not much more you can throw at an economy to support GDP growth and the performance of the equity market.

Asian economic activity improves

Elsewhere in Asia, current trends in economic activity appear to be improving. In the past week industrial production reports from Korea, Taiwan, Thailand and Singapore were ahead of expectations. Supply lines appear to have adjusted to the disruption from trade wars. Companies ran down in inventories due to worries about future orders – this now seems to have passed. The Taiwanese government revised up their forecast for third quarter growth to 2.99%. Indeed, the technology sector appears to be playing a significant role in the rebound in activity. The global information technology sector has risen 11.4% in the past three months, a marked outperformance over global equities up 7.9%. Elsewhere in Asia policymakers showed an intention to support their respective economies. In Thailand, the government announced spending of 100 billion Thai baht ($3.3 billion) to spur growth, while in the Philippines, the head of the central bank indicated that a rate cut was possible before the year-end.

China issues USD debt to follow successful EUR notes

Last week saw the issuance of $6 billion of Chinese government bonds in the global market, across the yield curve in 3, 5, 10 and 20-year maturity. The issuance came at 40 basis points above US government bonds of the same maturity. From the point of view of pricing as well as investor demand, this issue was a success. It follows an equally successful EUR-denominated placement of EUR 4 billion earlier in November.

The good pricing level for both rounds of bond issuance can be attributed to the strength of the government's financial position – this debt is directly government-backed – as well as strong demand from global investors who are hunting for yield but becoming gradually more discerning about quality. In this context, it is worth noting that the Chinese government's efforts to revive a flagging economy is not having as much success as earlier in the cycle. There are clearly some corporate sectors in China that are beginning to show some strain. In the bond market, this has led to creeping higher of credit spreads. By establishing a blue-chip pricing point for government bonds, the Chinese government is helping the market. However, beware of the weaker areas of Chinese credit. The additional transparency from an international benchmark for Chinese government debt will be insufficient defence against a further deterioration of corporate balance sheets.

Indian asset markets robust in the face of economic weakness

Foreign buying of Indian equities has provided a key support for the relatively good performance of Indian equities in November at a time of marked weakness in the economy. The third-quarter GDP report was below expectations at an annualised rate of 4.5%. Industry was the weakest component at just 0.5% contrasting sharply with the 7% achieved in the last calendar quarter of 2018. Manufacturing and Construction output growth has weakened dramatically, indeed the contribution of the manufacturing sector fell in the quarter. Industrial heartlands appear to be suffering from the weakness in lending by the banking sector and retrenchment in the secondary banking industry.

Policy makers and most investors face up to climate change

The institutional pressure for policies that arrest climate change continue to mount. Christian Lagarde continues to push a refreshing new agenda at the ECB. In the past week she pushed for climate change to be part of the strategic review for the ECB. The crux of the debate is the degree to which the ECB will make it even more difficult for old 'climate damaging' industries to get funded.

We are pleased to see that sceptics of sustainable investment are becoming an ever more dwindling number. In a study of institutional investors by Schroders, they found that those investors who did not believe in environmental, social and governance investing amounted to just 12% of the total down from 29% in 2017. 19% of investors said they don't invest in sustainable investment funds. Asia-Pacific investors remain the most sceptical, with only 67% believing that ESG investing will grow in importance compared to 84% in Europe.

November 25th, 2019

Policy Moves: ECB wants more, Boris plays it safe

- **The new ECB President wants a broader policy approach across the Union**
- **Calls for fiscal and industrial policy support for growth**
- **Data argues for no change, and possibly a further easing of policy**
- **UK election manifestos are on the table and the contrast is stark**

Lagarde at the ECB: What do we know so far?

In a significant speech delivered last week, the new president of the ECB, Christine Lagarde, gave away little by way of shorter-term policy signalling but did make some important statements about her views on European economic policy more generally. There was recognition for the fact that growth has been weaker after the financial crisis, without clear evidence of a return to previous levels. There was mention of the need to address the decline in labour productivity.

The most recent series of PMI data sets out of the Eurozone does not paint a picture of robust growth. At the overall level, the Eurozone manufacturing PMI is running at 46.6, where 50 is the "breakeven" level that indicates expansion or contraction. The next release is on the 2nd of December. In December 2017 the number was running at 60. It has been dropping since then. The Germany-only measure is running at 43.8, down from 63.3 two years ago.

The European performance, using this measure, is not encouraging. Continent-wide PMI's are running at the lowest level now compared since the nasty drop accompanying the 2012/13 debt crisis. At least the debt situation has been stabilised, certainly from the point of view of where yields are: Greece at 1.36%, Italy at 1.17% and Spain and Portugal at 0.4%. These levels are a world away from the debt crisis and illustrate two things: how low rates can go with concerted Central Bank effort, and how low they can stay absent strong growth and any hint of sustained inflation.

Such numbers put into context the ECB's view that the heavily-accommodate monetary policy that has been in effect since 2008 could have been even more effective, and with broader impact, if it had been backed up by other policies (read: fiscal and industrial) in a more coordinated fashion. Apart from mentioning the decline in public spending since the crisis, she also goes on to propound on more supply-side reforms that could take advantage of recent technological advances, address the needs of the environment, and deliver better economies of scale across the European economy.

It may be difficult to see just how the ECB could be immediately and directly involved in such a project, apart from maintaining its very loose policy settings essentially indefinitely. It has long been acknowledged that what is broadly known as the "European Project" is in need of an impetus to take it to a new level. Waves of populism and Brexit has forced the debate to the front and centre: Europe needs to find its relevance in the volatile global landscape and begin to deliver on the expectations of its citizens.

The Brexit Election

With less than 20 days left to polling day, this UK general election has already earned itself an unflattering moniker – the Appalling Choice election. Certainly, it is hard to recall two as dramatically divergent characters presented as candidates for prime minister. That is also reflected in the manifestos of the two main parties. At a time of crying need for a fundamental re-think of public service provision and cost, Labour presents an ultra-interventionist, high-tax-and-spend philosophy that would seem to deliver the highest tax burden on business in the developed world. It reflects a statist model of government that passed away almost 40 years ago, and would almost certainly if enacted, trigger a significant further discount on sterling assets. Yet, even supporters of this approach may doubt Mr Corbyn's ability to deliver, especially given the incompetence on Brexit policy culminating in a proposed neutral stance on a new EU deal that Labour itself would have negotiated.

On the other hand, the Tory manifesto published this Sunday stands as an exercise in caution and minimalism. Clearly, the lessons of the 2017 disastrous launch have been well learnt. Yet it appears devoid of any overarching message or strategy even as it feeds populist themes like potholes and hospital car-parking charges. It commits to no increases in the main tax channels but clearly wealth and business taxation is open to change. Many of the spending items have already been announced. Brexit is now a challenge to be legislated for at high-speed. The commitment to end the transition period at December 2020 still leaves open the possibility of a No-Deal cliff edge again, especially if an extension isn't sought by mid-summer. With minimal commitments beyond exiting the customs union and the single market and a sizeable working majority, a Johnson mandate might, however, allow him to resist the Eurosceptic right of the party. He might then negotiate a more pragmatic end-state agreement with the EU, rather than the bare-bones free trade deal some are advocating.

The polls themselves, with the usual caveats, are still pointing to Tory party majority. The retreat of the Brexit Party is seeing a swing to the Conservatives while the Liberal Democrats are struggling to make in-roads. The Labour Party share is holding up especially amongst the younger vote and in London but its manifesto launch has not triggered a bounce similar to 2017. The Tory 'play-safe' strategy seems to be working but markets are correct to sit on their hands at this point. Voting intentions vary hugely by demographic. In addition, big-ticket spending items from the Tories will have to be properly costed – dropping the cut in corporation tax is one example of balancing the books. More will follow in a sobering springtime budget round.

And in closing, one for the Efficient Market Hypothesis proponents to comment on. Last week, MSCI announced that it had reversed its decision to include a specific stock to be included in its China Index. Prior to this, the stock, ArtGo, had spiked as much as 2800%. The press release did not go into the specific reasons for the reversal but hinted at the potential for manipulation, a small free, and the like. The response in the stock was to erase pretty much all of the prior jumps, wiping somewhat more than $5 billion of its market cap in less than a trading session. Ouch.

November 18th, 2019

Don't Give Up on a Fed Rate Cut

- **Fed rate cut back on the cards?**
- **US economic data weakens – poor Q4 growth in prospect**
- **UK equities primed for outperformance**
- **Signs of eurozone financial sector reform**
- **Foreign investors keep the faith in Indian assets**

It was almost inevitable that when the markets had moved to discount virtually no Fed rate cuts in the coming twelve months that economic data would suggest otherwise. A week of poor US economic data had the US bond market rallying and economists questioning whether indeed a rate cut might be on the cards again. At this stage the market prices just a 33% chance of a rate cut at next March's Fed meeting. They may have to think again.

Last week's US economic data surprised to the downside

Signs are that consumer spending and the labour market may be weakening. The Atlanta Fed's GDP Now and the New York Fed's GDP Nowcast estimate of fourth-quarter GDP growth based on the flow of economic data fell to a range of 0.3% to 0.4%.

Industrial production fell 0.8% month-on-month in October, the third decline in four months. Retail sales rose just 0.1% in October, excluding volatile items such as auto sales. The retail data was no disaster but weaker than expected. Underlying trends appear weak; some measures of consumer confidence have softened in recent weeks, and initial jobless claims have risen.

US inflation remains relatively well behaved. There have been worries in recent months that a pick-up in US inflation could stymie the ability of the Fed to ease policy if there were more meaningful signs of a slowdown. However, in the event, the latest US inflation news was relatively benign. Core inflation at 1.7% is below the Fed's 2.0% target and the rental inflation number a key figure in the calculation down to the weakest reading on some years.

The equity markets continue to believe we are in a goldilocks environment where any disappointments in growth will be met with further easing of policy by the central bank. We can't disagree. The Fed Chair Powell in his testimony to Congress last week reiterated the Fed statement from the last meeting that the monetary policy remains data dependent.

The leadership of the global equity market rally has switched to Eurozone and Japanese equities in the past few months. Investors are taking the bet that policymakers in both areas will be supportive of their economies as we turn the year. However, given the double-digit returns from both markets in the past three months, investors may be looking elsewhere for action - stand up the UK market.

Has the UK equity market's time finally come?

UK equities are the marked underperformer in the year-to-date. UK equities are up only 8.5% against Europe ex UK and the US up 23.7% and 24.5% respectively. Of course, investors would prefer the certainty of knowing the election outcome before jumping in. At this stage, we would sense that the momentum is with the Conservative party. Commentators are increasingly confident they will achieve a majority in Parliament. However, two other outcomes fill investors with horror. The first would be that there is no overall winner and various complexions of coalitions cause havoc. Another would be a win for the Labour party or a Labour-led coalition that then sets on a path of left-wing 'reforms' to the economy and leaving a decision on Brexit to the vagaries of further negotiation and a likely second referendum.

We prefer to be optimistic, and indeed the balance of odds is that the UK electorate will vote in a Conservative government with a majority sufficient for them to initially complete Brexit. Beyond Brexit, there is likely to be a significant easing of fiscal policy. In our view, investors should focus on domestic plays probably through small/mid-cap indices such as the FTSE250. We expect returns from the equity market to be enhanced for foreign investors by a further rally in sterling against the dollar.

Euro area equities have been a stellar performer over the past three months. There are signs that the rather short-term outperformance could be supported by the creep of **reform in the eurozone, particularly in the banking sector.** There is still to this day a struggle to construct an integrated, fully functional banking union in the eurozone; one that has a single supervisor (the ECB) and a single, consistent resolution framework for failing banks of whatever size. For seven years, there has been huge resistance from Germany and the northern 'creditor' states to one key element – a single deposit insurance scheme across the union. They saw it as a covert form of transfer union that would leave well-supervised German savers and its taxpayers on the hook for ill-disciplined and delinquent southern lenders.

However, it does look as if Germany may finally be prepared to concede some ground. In recent weeks, Olav Scholz, Germany's finance minister, suggested in a paper (and in an FT op-ed article) that he might back a form of deposit reinsurance scheme that would be a backstop for the region-wide €100,000 deposit guarantee. This is potentially a significant shift just as a new EU administration is about to be installed. A single guarantee scheme would ease liquidity pressure on national banks during a flight from a particular sovereign's debt as well as reducing the risk of an intensifying credit crunch like we saw in Greece. It could, in some respects, justify a higher price to book ratio for smaller peripheral regional banks.

Domestic sentiment in the Indian economy is weak. Indian current affairs programs characterise the situation as a crisis. Could it really be that bad? For sure, the economic data is poor. Industrial production fell 3.7% in the third quarter, and the monetary system appears to have frozen over. The formal banking system has not been able to compensate for the marked deterioration of the shadow banking industry. Cuts in interest rates have had limited impact thus far because even if a company wanted to take advantage of the lower rates, you would struggle to find a willing lender.

This is certainly not the greatest crisis the Indian economy has faced, and one suspects it will just take time for things to be righted. However, it will take the significant intervention of the government to make things better. The BJP government has been reform-minded from the start. Yet, the pace of government reform has to follow the political cycle. As much as the Modi government may want to push ahead with reforms, they also realise that they have to stay on the right side of the electorate. The BJP and partners still must build a sufficient majority in the upper house to push ahead with more reforms. In the meantime, the central bank will be under pressure to provide further support for the economy. Despite the recent rise in inflation, some economists are hopeful for an additional rate cut before year-end.

Despite the near-term economic challenges, we still see good long-term interest from foreign investors to gain access to the financial markets. Indeed, against the problematic market backdrop, foreign investors have been buyers of Indian assets over recent months. They have used the markets absolute and relative weakness as a buying opportunity. Foreign portfolio investors invested a net ₹14,435.6 crore into equities and ₹4,767.18 crore into the debt segment during November 1-15, taking the total net investment to ₹19,202.7 crore. Foreigners were net investors in both July and August too.

November 11th, 2019

Japan Blinks – Others May Follow

- **Japan forced to ease fiscal policy – we await the scale**
- **Other governments are likely to follow – particularly the EU**
- **Risk assets always enjoy government's spending money**
- **Central banks may be forced into expanded QE to anchor long bond yields at low levels**
- **The US may cut an interim deal with the Chinese but the trade war is far from over**

We have warned that it was only a matter of time before governments stepped up to the plate and started to spend. Japan blinked last week as the economy stuttered. If the EU ever gets the other side of Brexit they will surely be next. Government spending delivers a step up in growth. It may also come to pass that it also leads to heavier QE from central banks as they are forced to buy bonds to anchor long term interest rates at close to zero. Equities may pick up the pace again. Government bonds may be challenged... but not for long. Central banks must surely ramp up QE further down the road. We expect Corporate debt and EM debt to remain in favour.

Here the Japanese go again. After some years of waiting to see if any of the "Three Arrows" would hit the target, Prime Minister Abe's government is being to reload, this time maybe with something of heavier calibre. In his defence, the current environment is not supportive of the previous stimulus. First, there is the threat of a slower global economy, especially if the trade war does not abate sustainably (see below); second, the country has to deal with the devastating impact of Typhoon Hagibis.

The Japanese government's imposition of a sales tax hike was entirely avoidable and quite frankly a policy error. Officials have protested that the impact of the increase will be negligible. If so, why not dispense with it? The underlying weakness of the Japanese economy has been masked by forward purchases of some durable items (fridges, for example) to avoid the sales tax rise. And, in a similar vein, there is some concern in policy circles that there is some "preemptive" investment spending going on in advance of the 2020 Olympic Games and that there will be a marked lull in the aftermath. Even with these one-off stimuli to the economy there are signs of underlying gloom; a recent services purchasing manager's index dropped below 50 for the first time since 2016.

Japanese policy makers had to act. We await the size and breadth of the fiscal stimulus. The Japanese government has given no specific size of an intended fiscal package, apart from the fact that the idea is for it to have a positive effect through to 2021. This would make some sense. Past experience with Japanese fiscal stimulus is a very mixed bag indeed. A limp effort this time around will be frowned on by the market. On the bright side, the Japanese bond market arose from its slumber recently, perhaps lifted by the global sell-off in government bonds. The 10Y yield is almost out of negative territory. As market hopes of a partial trade deal rose, a JGB bond auction went off quite badly. It was a rare buyers' strike by Japanese bond investors. A trade truce and a fiscal package may be what is needed for longer yields to rise more sustainably above zero.

Trade Truce

For even more bright news, look no further than the growing sense that there will be a trade truce between the US and China. Reports over the last week were that there will be some modest roll-back of tariffs, or maybe something more than merely modest. That was enough not just to impact on Japanese bond yields, but also sent the US and other markets higher and at the same time pushing equity markets into record territory.

Subsequent news flow did not do much to clarify precisely what kind of deal was in the offing. The venue for the meeting had to be changed due to protests erupting at the original venue, Chile. We await the sequel.

While the near-term outlook has brightened, the fog war of trade war is still on the battlefield. For now, the Chinese government's best tactic may be to run down the clock on Mr Trump, hoping he gets too entangled in the re- election campaign and possibly impeachment proceedings, to pay much attention to the issue between now and the end of the year.

However, this only buys time. There is still a chance that Mr Trump will prevail in the elections. The Democrats have too many candidates in the race right now, with Michael Bloomberg threatening to add to the line-up. In Mr Trump's camp, his two main trade advisors, Robert Lighthizer and Peter Navarro, are noted China hawks who are not very likely to counsel for a climbdown. Their motivation is not to try to shrink the trade deficit – a very difficult thing in its own right – but to alter Chinese behaviour in the field of intellectual property and technology. These are far more fundamental than bigger or smaller trade figures.

On the Democratic side of the aisle, there has never been a strong dedication for the free trade cause. A milder tone towards China might be forthcoming for geopolitical reasons, but the core of the stance is likely to remain hawkish.

In the meantime, risk markets rally. It is a good thing if there is even a brief respite from higher tariffs, especially for Asian economies. Keep in mind that a good definition of "truce" is that it is a period of cheating between two periods of fighting. As the market comes to terms with the details of the forthcoming truce, the scope for further optimism may be limited.

A further point of support for the equity markets has been the growing belief in a growth rebound. The usual rotation has been in evidence, as growth has outperformed value and bonds have sold off. Furthermore, credit spreads have narrowed across most sectors and regions, helping to shield credit investors from the worst of the rise in underlying government bond yields.

Looking at the progress of this quarter's global corporate earnings season does not make for good viewing. But to be fair, for the most part, mainly in the US, earnings have been ahead of expectations, but those expectations have been pared back significantly. On a year-on-year basis, there has not been much progress. With the general tone of the macro numbers in the US broadly supportive of the theme that the growth pause is over, the current positive sentiment in risk markets should persist for the time being.

November 4th, 2019

Fed cuts as expected, but not more of the same

- **Fed delivers a cut, as expected**
- **The accompanying statement hints that further cuts should not be viewed as a given**
- **Low for long is the order of the day, as Fed sees little inflation risk in the system**
- **Easy money policy continues to fuel risk appetite while suppressing bond yields**

The most recent Fed meeting yielded the expected rate cut: another 25 basis points. While it was quite widely discounted and transparently signalled, it has nonetheless had a somewhat positive effect on risk sentiment in the market, underscoring the market's belief that the Fed will err on the side of stimulus.

However, we would concur with the Fed, for now, that there may not be any reason to ease policy in the near term. That said, there is equally little to suggest that the reflation theme that animated markets in October is much more than just an indication that the late-cycle pause that we have been witnessing is moderating.

Equities showed an upward bias last week with the S&P 500 ending 1.5% higher. However, what would you expect in a country when the central bank cuts interest rates and growth for the third quarter is still running at close to 2%. But it's also surreal. The Fed HAD to cut interest rates because this expansion has at its core a massive increase in debt. Federal Debt has nearly doubled between 2009 and today to $22 trillion. The Fed is holding down long-term interest rates for fear that there could be a spike in long term interest rates that would hurt the government, indebted industrialists and households with mortgage and credit card debt.

We can argue forever that asset markets look expensive. Still, if policymakers continue to feed the overvaluation of markets with easy money, the day of reckoning is put off yet again. As we end the year some of the near-term risks to markets look quite benign however you still have to ask yourself why we are in a negative interest rate world with rates in many parts likely to fall further.

The bias of our equity focus is on domestic growth helped by the lower interest rates, thus benefiting smaller and medium-sized companies.

The easy money conundrum has been stalking global bond markets for some time. The Fed's recent call to reduce rates some more has not added much clarity to the longer-term question of what, if anything, will cause a "normalisation" of bond yields. The Fed has tried to take the position that the current set of data points does not warrant commitment to either tighten or loosen policy right now. The market has priced in a higher probability of a cut as the next move. The shape of the curve is still (more or less) positive, but the US 10Y yield is still below 1.8%.

For those who maintain that the huge reservoir of negative-yielding bonds is an affront to logic and that the situation will revert to the pre-crisis regime any time soon, the simple retort is to ask: What will be the catalyst? In the absence of any real indication of inflation, and with the global growth cycle showing increasing signs of vulnerability, why would one anticipate a spike in bond yields?

Even the bond bears have largely given up on inflation returning to the scene. Growth will be moderate next year, and possibly the year after that too. Central Banks are on cautious setting more or less everywhere, and in Europe and China likely more on easing mode than otherwise: in Europe, there are clear growth concerns, and China is alert for weakness driven by the trade war.

Instead, the argument goes along something like monetarist lines: a flood of money will eventually lead to inflation, and its current absence is merely temporary. Central banks are exhorted to hike rates to get on the front foot for the next downturn, given there is no space to ease policy from current levels if there is indeed a more severe slowdown in store. This argument looks a bit circular: rates have to rise to protect the economy from a time when they will have to fall again. Really? If the economy is not up to dealing with higher rates now at a time of reasonable US growth, what hope for the economy if the Fed was trying to deal with stagflation?

It is a good thing someone else is in charge of the Fed because this problem looks intractable. The growing US budget deficit compounds it. A mildly slowing economy this year and next will not help the US make its budget target. It would have been tough going at a 3% GDP pace; at 2% to 2.5%, the idea of budget discipline looks quaintly far-fetched.

For private investors unconstrained by the regulatory framework faced by banks and insurance companies – who are among the larger holders of negative-yielding bonds – the simple strategy is to avoid sovereign debt. In the realms of investment-grade debt, high yield bonds and some emerging markets, there is still enough bonds that are trading on reasonable yields; no need to dabble in Swiss or Japanese paper where one's capital erodes.

As I head off to the Web Summit in Portugal with 70,000 exhibitors, and investors in attendance focussed on new ideas, companies and technology, **there remains a positive vibe in the venture capital market.** A recent report by NVCA showed that while US VC activity is largely at the same level as last year, there is still much capital to be deployed. The deal value should again hit a healthy $100 billion for the year. While there have been a few disappointments in the pre-IPO market, there were $200 billion of VC-backed IPOs in 3Q. 65% of the exits are in $100 plus deals.

Saudi Arabia has announced the IPO of Saudi Aramco after much delay, the government is aiming to raise $60bn for the 5% stake placing a top-end valuation of $2 trillion on the company. The company will set out on a roadshow in the coming weeks. The company will list solely on the Saudi stock Exchange the Tadawul. The company has already committed to paying a $75bn annual dividend in the first year. A 3.25% dividend yield would be at the very top of integrated oil majors. There is much debate about the valuation of Saudi Aramco. Still, there is no doubting that this is a monumental step in the modernisation of Saudi Arabia and the vision of the Saudi Crown Prince Mohammed. Local investors are likely to be very supportive of the issue even if out of nationalistic pride. The issue embodies a vision of the future of Saudi Arabia that is of scale and international standing. No one should understand how big a deal this is for the political leadership and the standing of the country in the international community.

UK Election

Regardless of whether down to vanity, a cunning strategy or sheer frustration, the current, highly criticised and celebrated UK parliament is finally about to end, and the electorate goes to the polls on December 12th for the third time in 40 months. At this point, the odds seem to favour a working majority for the incumbent Tory party, allowing it to pass the amended draft Withdrawal Agreement by the new deadline of January 31st. The majority of opinion polls, as the campaign kicks off, suggest a double-digit percentage lead for the Tories over the Corbyn-led Labour Party. On most criteria, Boris Johnson is indeed the preferred leader. Yet, as with all things Brexit, nothing is to be taken for granted. The electorate is in an angry and very volatile mood. The British Election Study suggests that between 2015 and 2017, a third of voters switched parties while 43% changed in 2015 compared with 2010. At this stage in 2017, Mrs May had a lead of over 20%, but it largely evaporated in the subsequent bruising campaign.

We draw readers' attention to the following tentative observations:

- Boris Johnson must win a working majority (20 seats plus) to deliver Brexit. The objective of the Remain opposition will be effectively met if he fails to do so.

- Unlike the May 2017 general election, the smaller parties will start off on the front foot, especially the Liberal Democrats and the Scottish National Party, as they send out a strong Remain message.

October 28th

Fed Should Continue to Deliver

- **Fed statement as important as the likely rate cut**
- **US 10-year government bond yield looks close to their high**
- **We still favour emerging market debt**
- **Brexit still a mess – hopes for a break in political impasse to support sterling**
- **Oil prices strengthen but marked upside seems unlikely**
- **Green assets in short supply as wildfires rage in California**

The Federal Reserve should cut interest rates by 25bps this week. However, it's not so much about what they do, but what they say. The Federal Reserve may leave open the door to a further rate cut in December; however, the bond market prices only a 32% chance of a further rate cut at year-end. While the US economy is slowing the economic data is not showing it to be a disaster. GDP data for the third quarter due this week is expected to show growth of around 1.6% year-on-year. Economists also expect a slowdown in jobs growth in October with the consensus forecast at 90,000 new jobs below the previous month's number of 136,000.

Over recent weeks the US 10-year government bond yield has risen sharply from a low of 1.5% to 1.8%. We would be surprised to see the US government bond yields rise much further given the still lacklustre economic growth and minimal signs of significant inflation pressure. However, market positioning is long government bonds ahead of the meeting. Hence any disappointment with the Fed's comments about the future pace of interest rate cuts could push bond yields marginally higher at least in the near term.

While US government bond yields have risen, credit spreads have narrowed. The rise in yields will have attracted income-seeking investors who are still on a global hunt for yield. Also, the prospect of lower short-term interest rates improves the proposition for those investors who leverage their bond portfolio funded by LIBOR + short term lending facilities. US investment-grade spreads are down to 143bps in part helped by recent limited supply.

We remain constructive on emerging market debt in the short and long term. Lower Fed funds rates and the abundance of negative-yielding bonds is almost forcing more bond managers to consider emerging market debt. However, there is a more significant structural reason why interest in emerging market debt should build structurally over the next 12 months. By November 2020 Chinese bonds should be more substantially integrated into bond indices. The changes should increase the weighting of emerging market debt in global bond indices from around 9% to 15%.

Brexit remains a mess. Investors must be concerned that the political impasse that built last week may last for some months to come. The Labour opposition still won't agree to a general election while barriers are still put in the way enabling Brexit. Given what has happened, it is somewhat surprising that sterling has maintained the majority of its recent strength.

Sterling may gain some support from signs over the weekend that the Lib Dems and SNP have put forth a compromise on the timing of an election that could break the political impasse. If the Prime Minister loses the vote on Monday, he may reach an agreement with the Lib Dems and SNP whereby an election will be held on December 9th as long as the EU extends Article 50 until the January 31st. The bill to leave the EU would thereby be held over until after the general election most probably to be held on December 9th or 10th.

If the UK Parliament were to go into recess at the end of this coming week, due to the calling of an election, opinion polls would dominate sentiment in the markets. At this stage, there are signs that the Conservatives would win a majority, but nothing is for sure. Will Boris Johnson prevail in an election or will the UK be left with a mess of no party being in overall control? A recent opinion poll shows the Conservative party at 36% of the vote while only 23% would back Labour. However, polls also suggest that only 22% of the electorate believe the EU Brexit deal to be a good one. Also, more voters are blaming Boris Johnson and the Conservative party for the delay in leaving the EU than Jeremy Corbyn and Labour.

Sterling seems to be discounting that surely there has to be some political resolution. The pound was down 1.2% on the week to $1.2821 but was generally holding onto recent gains. Technical analysts see the sterling consolidating above the $1.2720 level before re-establishing an uptrend to a target of $1.3410.

Oil prices were up sharply on the week, but there remain significant challenges to OPEC's hope for higher prices. The rise in oil prices came on the back of news that OPEC+ are looking to cut output further in 2020 to support prices. The next OPEC meeting is in December. WTI spot oil price rose to $56, up 4.5% on the week. Such stories have been a feature of the past few months, but they have failed propel oil prices remarkably higher. Oil prices are virtually unchanged over the past nine months, and dark clouds continue to hang over the market. The weak global GDP growth, strong oil supply growth from the US and an acceleration in competition from renewables are all challenges. The EIA estimates show that renewables are set to provide 31% of global energy supply by 2040 up from around 25% today.

PG&E the US utility company we mentioned a few weeks ago remains the primary scapegoat in California for wildfires that have now led a state-wide emergency. PG&E is due to cut off power to 940,000 households and business impacting two million people. Sparks from the overhead cables are igniting bone dry scrub that turns into massive wildfires. The core problem however is climate change. Fifteen out of the 20-recorded serious wildfires in Californian have occurred since the year 2000. Ironically PG&E Ironically PG&E has been one of the most substantial investors in renewable energy in recent years.

Trying to invest in assets that can change the world remains challenging. For example, the funding for green initiatives remains a tiny fraction of global bond markets. As investors increasingly turn to ESG investing, they struggle to find sufficient eligible investments, particularly in bond markets. The largest green-credit universe is in Europe. However, only $100 billion of credits are in issue barely 3% of the broad index. The good news is that green bond issuance is growing at 25% per annum.

October 21st

Chaos Confusion and Suspense

- **Another Brexit saga but the UK Prime Minister may still push it through**
- **Sterling may initially sell-off but traders fear the upside as much as the downside**
- **Latin America sees trouble in Chile and Ecuador, but Brazil and Mexico retain positive bias**
- **IMF cuts GDP forecasts and ups its research on climate change**
- **Institutions increasingly focused on implementing ESG strategies**
- **US government increasingly taking over the uninsurable.**

Chaos, confusion and suspense are never far from the Brexit saga. This weekend certainly filled the bill. Mr Johnson's intended Super Saturday of success was transformed into a damp squib. The success of an amendment to the motion approving his deal with the EU27 means final sign-off will be delayed until all the 'enabling' legislation has passed into law.

On the face of it, the Prime Minister may still get his way even if there are more hurdles to overcome. Indeed, the voting pattern on Saturday suggests that the most likely outcome is that the amended Withdrawal Agreement is eventually approved by Parliament in its current form and the UK departs the EU after a technical delay.

Yet, as ever, danger lurks. The big Boris Johnson push has had its momentum broken and an extended period of debate on the hard-fought agreement may expose its shortcomings. The EU27 still have to respond to the UK's request for a delay. A delay cannot be taken for granted. Many still believe that it is most likely that the EU will give an extension but for how long? A month to allow approval by both UK and European parliaments or longer still to cater for a UK general election if the Commons rejects the agreement. For now, the European Council will hold fire to see what happens in London in the coming days.

The disappointment of a messy weekend is likely to weigh on sterling after the run-up of recent days initially. However, now that the traders have seen the upside potential rather than the perennial gloom that had previously prevailed the near-term setback in sterling could be modest.

We sense the markets wants to price better news if only Parliament would deliver. The good potential news though is that the relief of the UK's departure from EU and some semblance of certainty should boost UK economic activity going into 2020. A rebound in investment spending, improved business and consumer sentiment and of course a pending fiscal boost should see at least 1% added to GDP in 2020.

Further out, there will be reflections on the fact that the deal negotiated by Boris Johnson does differ in tone in comparison with the May version. It looks in the future to a form of managed divergence with EU regulations and standards compared with the earlier alignment approach. This will be central to negotiations (as well as the debate in the upcoming UK general election) over an eventual free trade agreement. The UK negotiating leverage may well be weaker no doubt, but the EU is itself already alert to this challenge and will want to see the long-term relationship nailed down as quickly as possible.

Chaos confusion and suspense are increasingly the tone of Latin American politics dragging down the economies and markets. Chile was the latest country to see popular anger. Chilean President Pinera was forced to suspend an increase in subway fares to violent protests. As in other countries, student protests have morphed into broader movements for change. Chile is facing its toughest political challenges since the end of the dictatorship of Augusto Pinochet. Argentina is in the midst of an election for the next President with a left-wing Peronist looking likely to win over the incumbent. Latam financial markets are challenged. However, the good news is that Latin American heavyweights Brazil and Mexico are doing enough to keep investors engaged. Brazil continues with a reform programme and although Mexico has hit a problem this past weekend with the arrest and release of a member of an infamous criminal family increasing confidence that US-Mexico-Canada trade agreement can be amended and agreed by Congress has helped sentiment.

The IMF was busy announcing cuts to its global growth forecasts in its mid-year update. It now expects global growth to be 3% in 2019 – down from 3.6% last year and a 0.3 percentage point cut from its April forecast. The IMF expects growth to pick up in 2020 to 3.4%, but that represents a downgrade from the 3.6% forecast six months ago. Worryingly, the IMF pointed to the fact that central banks were using their ammunition to stave off the effects of the trade war, leaving fewer options if a recession were to set in. The IMF calculates that global growth would have already been running at a pace 0.5 percentage points lower were it not for lower central bank policy rates in recent months.

Concerns over climate change point to a future of potential chaos, confusion and suspense. The IMF has announced that they have finally got around to investigating the potential impact of climate change. New IMF MD Kristalina Georgieva announced that "the IMF is gearing up very rapidly to integrate climate risks in our surveillance work". The IMF's new focus comes as recent data from NASA shows that observed levels of carbon dioxide continue to rise almost every month. The latest reading from NASA at 412 CO_2 parts per million compares to just less than 380 in 2005.

There are signs of the US private sector extracting themselves from markets prone to climate change. However alarmingly the private sector is being replaced by the public sector as lender and insurer of last resort. For example, according to a Harvard business review, hardly any private insurance company retains residential flood risk in Florida or Virginia. Government-subsidised programmes are having to take up the risk. A recent paper from the US National Bureau of Economic Research showed that commercial banks are offloading mortgages on properties at danger from climate change on to the government agencies of Fannie Mae and Freddie Mac. Governments may be well-intentioned, but they are building a sizeable contingent liability.

Bloomberg ran a story this past week, showing that some institutional funds are starting to snub the $16 trillion US Treasury market based on ESG criteria. The French state pension fund is amongst major European funds that are shunning Treasuries due to the US government's stance on climate change and/or capital punishment. I'm not sure Donald Trump will be losing sleep over the matter, but it's maybe a taste of what is to come.

October 14th

Trade wars and Brexit turn positive, but for how long?

- **A trade deal – maybe a little one**
- **Hopes for a positive outcome from the 'tunnel' of Brexit negotiations**
- **If a Brexit deal is done sterling to $1.35, European equity market rally led by UK**
- **Demise of US utility company PG&E shows why ESG is so important to investors**
- **Trouble in the US food industry is no chicken feed for investors**

As last week ended, a trade deal between China and the US was pending. To add to the good news, an orderly Brexit looked distinctly possible. However, neither is in the bag. The President can always change his mind – the Kurds have tragically been reminded of that this past week, and the EU and the UK may end this coming week still at loggerheads. However, the markets are at least being given more positive issues to take onboard. Our feeling at this stage is that an orderly Brexit could have a more significant impact on some markets than a limited trade deal.

Trade deal? Maybe a little one

If we are to take financial market moves last Friday at face value, one would be forgiven for thinking that the "trade deal" amounts to a significant leap forward. We believe the immediate substance is very limited. China has committed to buy US agricultural products, much as promised before. In return, the US reduces, marginally, some of the tariffs threatened. There is not, at this stage, any significant rollback of tariffs.

The most logical interpretation is that **the market is viewing these superficial concessions, as the beginning of a broader agreement.** The markets hope that this is the start of trade peace between the US and China. This looks to be very optimistic, in the short term and beyond the 2020 US Presidential elections. By now it is clear to all that the US objective, certainly under this Administration, is more than merely trying to redress the trade imbalance with a set of punitive tariffs. The more general goal is to contain the technological rise of China for a long as possible and to maintain the lead that the US currently enjoys.

Therefore, **an overly optimistic interpretation of events by the markets is premature.** The battle for economic supremacy is fully underway and will only be intermittently interrupted with some concessions here and there on the trade front.

Brexit talks go to the wire and into the tunnel

Finally, we have seen brinkmanship and a genuine attempt for both sides to concede some ground in search of a deal. Brexit talks are now in a so-called tunnel with a news blackout. Some news is almost inevitable before the end of the week. The House of Commons is due to sit on Saturday 19th. The UK Prime Minister will have hoped to have negotiated a deal with the EU by then.

UK sterling has already rallied to the US$1.265 level in anticipation of a favourable outcome. The bias of risks still seems to be the upside. The worst outcome is still likely to be an extension to the UK's membership. In our view, the pound would drop back to the US$1.22 level. The hope is that the UK and EU reach an agreement and the UK leaves in which case a rally to $1.35 is entirely possible.

If the UK leaves the EU on the 30th October with a deal, the UK and EU corporate sectors will breathe a massive sigh of relief – finally some certainty. Brexit has dogged sentiment for the past six months if not longer delaying corporate decisions and adding a layer of costs to companies as they provisioned and planned for all outcomes. A collective sigh of relief could help European equity markets rally sharply, particularly UK equities. UK equities on a dividend yield of around 5% and sitting on a 40+ year price relative-low will be attractive to global asset allocators. UK smaller companies represented by the FTSE-250 with a domestic bias are likely to be the clear winner.

Environmental, Social and Governance investment issues are on our minds this week, and beyond

Investors got another wake-up call this past week on why there is a need to invest with at least half an eye on Environmental Social and Governance issues (ESG). In another manifestation of the impact of climate change on financial markets, PG&E cut power to 500,000 homes in California this past week as it struggled to avoid further liabilities for starting wild forest fires. The Company is in Chapter 11 bankruptcy. Barely a year ago, the share price was riding high at close to $50 today it is at $8. A few decades ago, the Company was part of the climate change denial organisations today it is a victim. PG&E electricity lines have acted as the spark for major forest fires across Northern California. Sparks from line ignited bone dry Californian forests. According to National Geographic, fifteen of the twenty largest wildfires in California history have occurred since 2000. And since the 1970s, the amount of area burned in the state has increased by a factor of five.

Those impacted by the cost of forest fires stretches well beyond PG&E. The consequences of forest fires lead to significant insured losses, subsequent sharp increases in insurance premiums and likely significant increase in the cost of energy to the consumers.

PG&E a wake-up call for the bond market

Credit investors have been sheltered from the inexorable ESG tide that has engulfed equity markets. The recent default of PG&E signals that things are changing. Green bonds have been around for a long time, but the notion of full ESG integration has not taken off as strongly in bond markets as in equity markets.

Recall that the costs incurred by PG&E related to California wildfires are the proximate cause of its default in this instance. It is probably the first instance of a default linked to climate change in such a direct way. The whole ESG approach does have its detractors, and admittedly it has its imperfections, but this case illustrates that increased attention to ESG could be beneficial to bond investors.

Climate change has much to do with economic externalities. For too long, the costs of carbon emissions (just one example) or other environmentally degrading practices have not been borne by the entities producing them: textbook examples of negative externalities. The upshot has now become clear: climate change and all that comes with it.

The future will bring with it far more accountability for firms that transgress. Investors can deal with the risk by taking fuller account of ESG criteria, upfront when new issues are launched but also on an ongoing basis. It is not clear that it may even have helped in the case of PG&E, but in future, there will inevitably be greater emphasis on environmental issues for bond issuers. This is a good thing not just for the overall cause of a cleaner planet, but also for bond investors who should not be the unsuspecting sponsors of corporate neglect.

A common argument raised in this context is that there are many more bond issuers than listed equity firms and that it is, therefore, more difficult to ensure a global reporting standard for bonds compared to equities. Listed firms have an obligation to exchanges to report on a very long list of things on a quarterly frequency. Such reports form the basis of their ESG score. Bond issuers do not all face the same level of scrutiny, as a stock market listing is not a requirement to raise capital through the bond market. It will be up to market makers, investors and the issuers themselves to develop the framework in a way that benefits and participants in equal measure.

US chicken industry too big to fail

We often talk about the concept of banks being too big to fail, to that I would add the US poultry industry. However, recent issues in the industry are deeply troubling. US consumption of chicken in the United States has risen dramatically over the past up over 50% since 1990 to 45% of total meat consumption. Over the same period, red meat consumption is down close to 10%. Hence it is worrying that in the past few months, the poultry industry has been hit with a number crisis. Just last week the US Department of Agriculture widened a recall of chicken across several large supermarket and restaurant chains due to concerns about listeria. Tyson Foods in August was forced for the fourth time this year to recall chicken products for having non-food material in its chicken. As reported by the modernfarmer.com Each recall was a Class 1 status “This is a health hazard situation where there is a reasonable probability that the use of the product will cause serious, adverse health consequences or death.”

Meanwhile Costco is moving downstream and investing in new chick rearing facilities in Nebraska that will process 100 million chickens a year. The chickens grow to 42 days until they mature into six-pound broilers. The investment is part of their aim to maintain their offer of a $4.99 Costco rotisserie chicken but also to maintain bargaining power with food producers. One hopes that corporate profitability is not seen as more important than food quality… recent evidence across the industry is that it is!

Bottom line, the defensive food industry is as much in the front line of ESG as any other, indeed maybe more than any other industry. Stock pickers are reminded to check the ESG scores of their favourite companies. For a good resource refer to https://www.fairr.org/.

For more on the PG&E story refer to https://wke.lt/w/s/R72I6v

For more on the chicken industry troubles refer to https://wke.lt/w/s/2wfsSZ

October 7th

Fed Challenged to Stand and Deliver

- **Fed could be tempted to cut in October – supporting more gains for US government bonds**
- **US employment growth loses momentum and manufacturing sector on the back foot**
- **Brexit discussion become more focussed but lack clarity of outcome**
- **EU still striving for political cohesion to tackle the challenges at hand**
- **More confidence EU could deliver a coordinated fiscal boost – good news for EU equities**

Friday's US Labour Market report leaves the market somewhere in no-man's land as far as Fed rate expectations go. On its own, it was undoubtedly a pretty solid number, showing 136,000 new jobs in September, and the unemployment rate down to 3.5%, the lowest since 1969. The context, of course, is the broader picture painted by some weaker industrial confidence data and the upcoming Fed meeting at the end of October.

Market expectations for another 25 basis points cut have been tempered – running at 50/50, give or take. The employment report is probably not strong enough to fully persuade the Fed to leave rates on hold, nor soft enough to trigger any alarms. Even so, the labour market is doing fine, but showing signs of slowing down. Taking out the noise from volatile monthly numbers, the pace of new job creation is the slowest in around seven years.

Other measures of activity are also flagging that the US economy may have some issues running into 2020. The ISM survey of industrial confidence is one such measure. For the first time since 2009, the aggregate index has dipped below the "breakeven" level of 50. Arguably, this is more significant than the yield curve inversion. It is more difficult to argue away the slip in manufacturing output (and easing job creation) than localised curve inversions driven by a variety of potentially exceptional factors.

On balance, the US economy looks more vulnerable than it did two to three quarters ago. The Fed has eased, granted, but it is now an open question whether or not it will feel it has taken out enough insurance against any further shocks. The global geopolitical situation at the moment is not conducive to a feeling of stability. The trade war between the US and China may potentially become conflated (at least in the mind of Mr Trump) with the escalating impeachment risk he faces. Even if his handlers persuade him to keep the issues apart, a full rapprochement to China looks to be off the table. The market will have to deal with a new tariff structure, come what may. **Putting all of this in the mix, we think the Fed may err on the side of caution and slip in another rate cut this month.**

The US 10-year government bond yield swing around markedly during the week with an intra-day move from 1.76% to 1.65% as the data hit traders' screens. It as only back on September 13th that yields were as high as 1.90%. By the end of the week the US 10 year was pricing ongoing economic trouble at a yield of 1.52%. 2-year bond yields fell 22bps on the week to 1.40%. **After such moved the market may have to pause for breath, but technical analysts see the next target of 1.33% for the 10 year. After last week's move that could be seen with in a matter of days!**

UK: Brexit Endgame Approaching?

Despite the outward show of bravado, Prime Minister Johnson has, in essence, lost control of the Brexit process. He is now cornered by his slogans, EU27 red lines and parliamentary arithmetic. At one end of his unappealing range of options sits significant concessions to the EU allowing for Northern Ireland's inclusion in its customs union, avoiding a border on the island of Ireland but unlikely to be backed by his party's Eurosceptic wing. At the other, a major constitutional, legal and political confrontation as he contemplates defying the Benn Act that insists he seeks a 3- month extension to the Article 50 deadline on October 31. We doubt he has the stomach for either option. Analysts now see only a one-in-five chance of the UK striking a deal with the EU within the next 12 days and in all probability any effort to facilitate a crash-out at the end of the month will provoke a confidence vote in the House of Commons and, with it, potentially the end of his premiership.

So it appears as if events are pointing to an extension followed by a pre-Christmas general election with Mr Johnson running a People vs Parliament campaign looking for a mandate for a No-Deal if the EU will not compromise. The Tory strategy will be to squeeze the Brexit Party vote and split the so-called Remain Alliance in what is described as the '35% campaign'. This is considered to be the share of the electorate that is adamantly Leave regardless of the method employed. It may be enough to return Boris Johnson to Downing Street but carries significant risks. Nigel Farage will point to yet another failure to deliver by Johnson. Likewise, a programme of tactical candidate selection across Remain parties is plausible, though the Labour Party's participation is essential, especially in southern English seats which would advantage the Liberal Democrats.

Having failed to sustain a rally in recent weeks, we would still expect sterling to weaken toward the end of the month, especially as economic data disappoints. A Conservative party election campaign manifesto that includes a commitment to a hard Brexit is unlikely to be a basis for a recovery in the currency either.

Europe: About to light the fiscal fires?

ECB President Mario Draghi is in the final days of his term of office and even now is not far from controversy. In this case, he is making some significant positive comments concerning the prospects for an integrated fiscal policy for the European Union. He certainly detects something in the air, especially as President Macron leads a campaign for EUwide policy solutions to tackle populism. The incoming Mrs Lagarde has hinted at the same thing.

The blockage to a greater political union is still the fierce resistance of the northern European countries (Germany in particular) to any form of transfer union or standard debt instrument. The Macron pan-Eurozone budget proposals were watered down earlier in the year, but a structure is emerging that might offer a basis for a more cohesive EU in coming years. One potential route is the use of a 'safe asset' euro-denominated type debt instrument as a financing source for regional infrastructure spending. This will move the discussion away from the contentious debate around EU efforts to commit to policies to stabilise countries in a cyclical downturn- something that Germany feels uncomfortable with. The EU discussions could lead to the development of an asset of appropriate quality in banks' reserve asset base, hence fusing the fiscal, monetary and banking unions. The Eurozone does not have the luxury of ignoring this choice – monetisation alone will not rescue the region from the next crisis.

Any shift in the fiscal stance across the continent could create a tactical opportunity in European stocks. It has been a poor performer for a significant period, but there are emerging signals that this may have runs its course. Apart from being a serially under-owned asset globally, valuations versus other markets are going from undemanding to cheap.

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