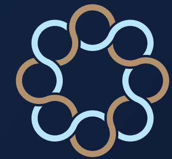

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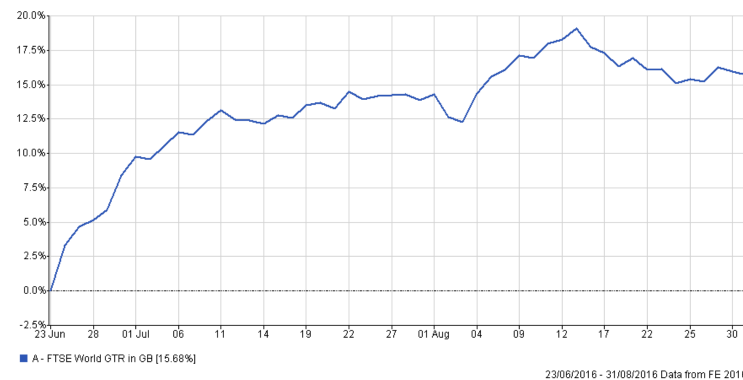
POINTS OF VIEW

MONTHLY COMMENTARY FROM PARMENION INVESTMENT MANAGEMENT

The FTSE World index nudged up by 1.2% during the month of August. Usually, the news flow becomes more subdued in the summer months, but in the UK and the US, politics has maintained its interest.

Although the UK has not yet invoked Article 50 and hence set the timetable rolling to leave the EU, there has been much discussion about the possible outcomes for both the UK and Europe, as yet to be determined. In the US the Presidential election in November is fast approaching. Will Trump be an unexpected winner?



United Kingdom

The FTSE All Share enjoyed another positive month with a gain of 1.9%. It appears that the worst immediate fears post the result in late June have not yet turned to reality. This certainly appears to be the case with the stock market. The FTSE All Share is up over 15% post-June 23rd (see chart above). Consumers continue to spend, perhaps a result of the low savings rates since Bank of England lowered the base rate to 0.25%, the first change in rates since 2009.

"It appears that the worst immediate fears post the result in late June have not yet turned to reality."

Although some forward-looking surveys of the economy do suggest a slowdown in activity, at the moment there is little hard evidence that this is occurring. And with the fall in sterling post the vote, overseas tourists are now finding the UK a more attractive destination along with "staycation" locals.

United States

Likewise, the United States rose by 1.5% in august resulting in a gain of over 21% for the year to date. The economy continues to generate new jobs (1.3 million, year to date) and the unemployment rate in below 5%, combined with some modest wage growth of 2.6%. Of perhaps more interest for the stock markets however, was the meeting of central bankers at Jackson Hole, Wyoming. In particular, the speech by Janet Yellen was much anticipated. She hinted that if new job figures continue to increase and inflation picks up, then yes the Federal Reserve will be inclined to increase rates but in the future, but she gave no specific idea of when. Perhaps her caution was justified given the economy just grew at 1.1% in the second quarter of 2016.

Japan

Despite a lacklustre economy, Japan's unemployment rate fell to a 21 year low of just 3%. Offsetting this good news was the fact that the economy just grew at 0.2% to end June and that inflation remains the target of 2%. Earlier in the month another stimulus package was announced of $276bn. It includes spending on infrastructure projects and reconstruction of regions affected by the earthquake in 2011.

Emerging Markets

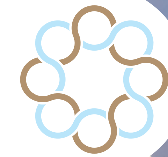
Year to date the Emerging markets have risen nearly 30%, outpacing Developed Markets. This month one of the leading emerging markets, Brazil, hosted the Olympics. Since the beginning of 2016, the mood towards Emerging Markets has significant changes. From being the dull laggard, performance is now up sharply and EM funds are enjoying strong inflows. China which is perhaps the mainstay of the sector saw its factory activity expand at the fastest pace in nearly two years. And although Brazil has just signed off on hosting the Olympics, it is again hitting the headlines with the impeachment hearing of its President Dilma Rousseff and her subsequent removal from office.

Europe

Similar to the UK there appears at the moment no serious effects from the June Brexit vote. Eurozone economic activity was at its highest level for 7 months in August. The Purchasing Managers survey (PMI) is an indicator of activity in both manufacturing and services. A PMI score of over 50 indicates growth of economic activity whilst below 50 indicates the economy is contracting. The August score in Europe was 53.3 up from 53.2 in July. However, inflation remains weak at just 0.2%.

* All performance data quoted in this article is derived from FE Analytics

First published on 8th September 2016 by Simon Brett of Parmenion Investment Management.



WHAT DOES LOOSE MONETARY POLICY MEAN FOR PENSIONS?

At the last gathering of the Monetary Policy Committee (MPC) a cut in the Bank of England (BOE) base rate to 0.25% was announced alongside a further £60 billion of Government Bonds purchases, £10 billion of corporate bond purchase and a credit facility for banks of up to £100 billion.

This was widely expected by the market and we have seen equity markets rise along with the capital value of fixed interest assets. But what are the effects on pension savings?

For individuals in Defined Contribution schemes who are still in the accumulation phase of life, the announcement will have been beneficial in the short term as it has caused a reasonably significant rally across most asset classes. However, for those in the decumulation phase of life or in Defined Benefit schemes the effect is radically different.

The buying of bonds by Central Banks around the world has pushed the incomes on offer down to historical lows and some Government bonds, i.e. in Switzerland and Germany, offer negative yields.

This means you effectively pay to lend those Governments money. The knock-on effect is that income is harder and harder to come by and investors are being forced to take more and more risk with their savings to generate the income they need.

Therefore, there is now a definite need to generate retirement income through a combination of natural income and capital growth, an aspect of the current market environment our new Guardian solution has been specifically designed to address.

For those in Defined Benefit schemes the outlook is pretty bleak. Scheme actuaries use an investment technique called liability matching which relies on the income and maturity value of bonds (particularly Government bonds). Because all UK Government bonds now trade above their par value, actuaries are having to contend with capital losses at maturity together with historically low yields.

Furthermore, as my colleague Harry Garret highlighted in the Q2 QIR, the way that Defined Benefit schemes' liabilities are valued means that many are in deficit, i.e. they do not have enough assets to be able to pay out the members' future incomes, which is ever growing through no fault of their own but instead as a result of the actions of central banks.

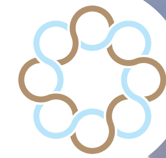
Anecdotally, this is leading to some Defined Benefit schemes offering inflated transfer values in order to tempt members to take the liabilities off the company balance sheet and assume the investment risk themselves.

Finally, the effect on annuity rates has been dramatic. The rate on a level annuity with no guarantees or spouses benefits for a 65 year old is now about 4.9%.

This makes retiring on a secured income unaffordable for the majority of savers in the UK and brings into question whether "Pensions Freedoms" will be used more and more.

We recently launched our exciting new Guardian solution which has been specifically designed to support long term decumulation. We think that Guardian will help alleviate some of the pressures mentioned above for those approaching or already receiving an unsecured income in retirement.

First published on 16th August 2016 by Stephen Lennon of Parmenion Investment Management.



AROUND THE WORLD AND BACK AGAIN: HAS THE GLOBALISATION THEME TURNED FULL CIRCLE?

2008 may come eventually to be seen as the peak in the trend towards globalisation, the point at which the tide turned and the global spider's web of supply chains and trade routes began to shrink.

For several decades we have witnessed a continued expansion in the trade between economies around the world, crisscrossed by container shipping and air transport, as every nation became more and more economically intertwined with everyone else. Efficient transport and communication allowed low wage economies to offer sites to sophisticated manufacturing for global export at highly competitive prices. Globalisation has had a profound impact on economies and societies around the world, but nothing lasts forever.

Globalisation involves allocating capital and resources to areas which can produce most efficiently and so provide the highest level of return. And while capitalism and globalisation can be credited with pushing innovation and growing the more backward economies of the world, they also share the less progressive trait of widening disparities in wealth. And it is inequality which is now driving political trends in the developed world.

Rightly or wrongly, many people viewed Brexit as a chance to vote against globalisation. With Nigel Farage seen as the poster boy for rising up against the establishment, many perceived this a decisive change of direction.

A moment to say 'No' to continued interdependence and integration, with its overtones of corporate hegemony, and 'Yes' to seizing back control over your own country. After all, a side effect of globalisation has been the export of employment in manufacturing which, in retrospect, seems to have offered a stable job market and a sense of belonging.

Source: data.worldbank.org

Away from the macroeconomic level we can see related changes in everyday life. The market for home grown produce has grown much bigger, with an emphasis on supporting local producers and cutting down 'food miles'. Within Bristol, for example, we have the 'Bristol Pound'; a currency that can only be used to buy from local businesses.

However, while changes in social attitudes are important, it's technology that has the potential to play the pivotal role in reversing the trend of ever more globalisation.

Advances such as 3D printing (additive manufacturing) can make it cheaper and more efficient to make a product close to the purchaser rather than utilise materials and labour from elsewhere in the world and then ship the product home. It allows different products to be created with the same tool and without the requirement of mass production to achieve cost efficiency.

With these breakthroughs the need for transportation and storage decline, with localised manufacturing working in step with local demand.

Renewable energy is also reducing the scale of global transportation. While fossil fuels require vast infrastructure to extract, refine and distribute, solar and wind power – while reliant on the elements – can be location specific.

Tankers and shipping containers become less relevant, as does the dependence of nations across the supply chain on those with oil in their soil or inshore waters. This can change political alignments.

Virtual reality (VR) is another factor with the power to amplify the benefits and remove the restrictions inherent in technologies such a Skype and video conferencing.

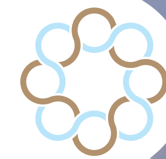
Interacting with a real person will always be preferable to watching a screen.

For now, long distance business trips and meetings still have their place but there will be a point when VR improves enough to make it close enough to real life to make the trip a waste of time.

The merits of business class plane travel will be irrelevant and the manner in which global business is conducted will be redefined.

So while politics and trade agreements might make the headlines, it may well be technology which quietly pulls the strings in the background and ushers us, albeit gradually, into a new age of regionalisation.

First published on 1st September 2016 by Jasper Thornton-Boelman of Parmenion Investment Management.

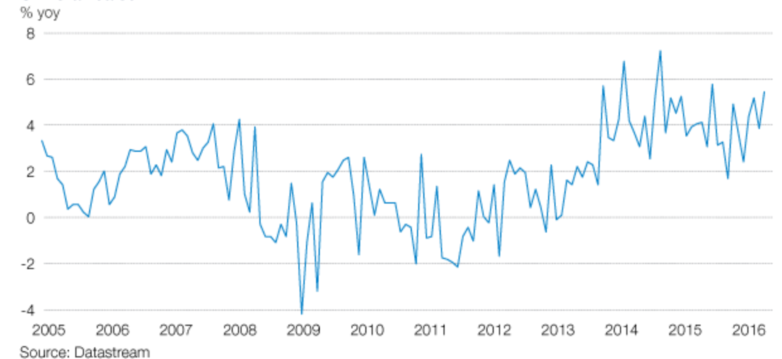


KEEP CALM AND GET A GRIP ON UK DATA POST-BREXIT VOTE

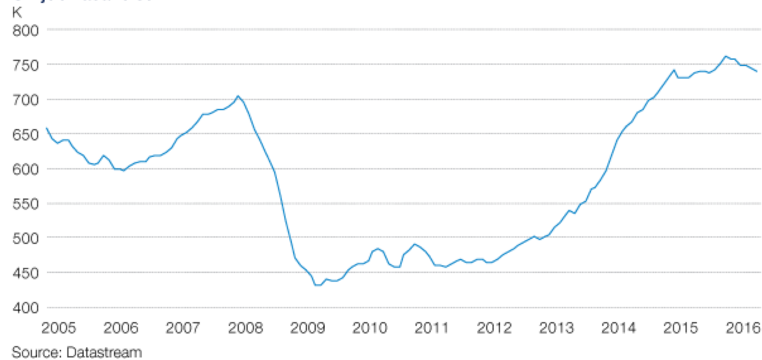
In our previous July Points of View ("the post-referendum siren of the UK economy"), we discussed that although UK business and consumer surveys showed a sharp fall in confidence in the immediate aftermath of the Brexit vote, it is still too early to conclude that activity has deteriorated.

As we start to receive official economic data for July, the data confirms our expectation that UK activity has been resilient so far.

Although the UK GfK consumer confidence nose-dived after the Brexit vote, retail sales were up 1.4% in July, well ahead of market expectations. This confirms solid consumer spending despite the dismal survey measures amid economic uncertainty. The resilience in consumption in July was also validated by the British Retail Consortium (BRC) sales report and the John Lewis weekly retail sales figures. It does not appear that households have reacted negatively to Brexit yet.



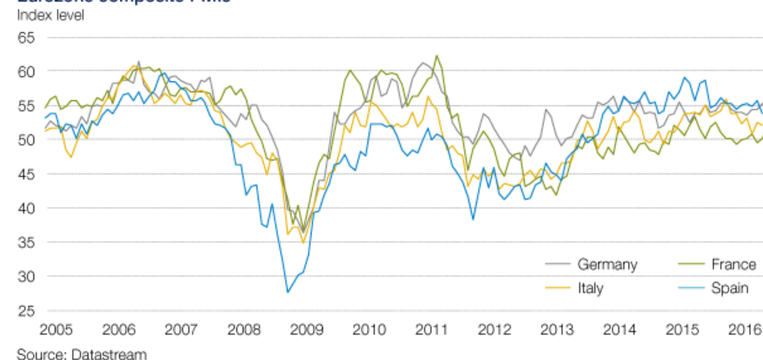
Although we are still in the early stages of the aftermath of the Brexit vote, the UK labour market data is showing no sign of negative impact either. Job vacancies dropped trivially in July but remained robust. As employers' concerns about the economy are usually expressed through a reduction in jobs being advertised, the resilience in vacancies shows the situation is not as pessimistic as some surveys have suggested. Due to the strength in the labour market, household consumption is unlikely to plummet.



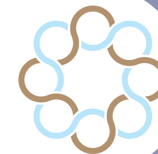
On the business side, the UK Purchasing Managers' Index (PMI), (a survey-based indicator of business activity) dipped into contraction territory in July. While Brexit uncertainty will most likely weigh on business investment, we may hear from an increasing number of corporates that they will do more to develop new markets and opportunities. For instance, the £540 million joint investment by GlaxoSmithKline and Google to form a bio-electronic research centre, and SoftBank's £24.3 billion purchase of ARM Holdings shows that multinationals are undeterred by Brexit and remain confident to invest in the UK.

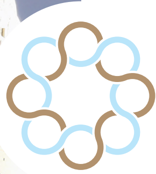
Although the early signs post-Brexit are positive so far, we are cognizant that the impact will take time to show and we will closely monitor how hard data evolves over the next couple of months. While we acknowledge there is a lot of uncertainty and the road ahead will be turbulent, we think the consensus of the UK growth expectation of only half a percent for 2017 appears too pessimistic and there maybe potential upside surprises.

With regards to monetary policy, the Bank of England (BoE) is expected to cut interest rates from 0.25% to 0.1% by the end of the year, but has signalled its reluctance on negative interest rates. Although there are signs that inflation is picking up (e.g. the bounce in producer prices in July), the BoE will be inflation tolerant. We believe the extensive easing measures that the BoE has introduced in its August meeting are more counter-productive than helpful.



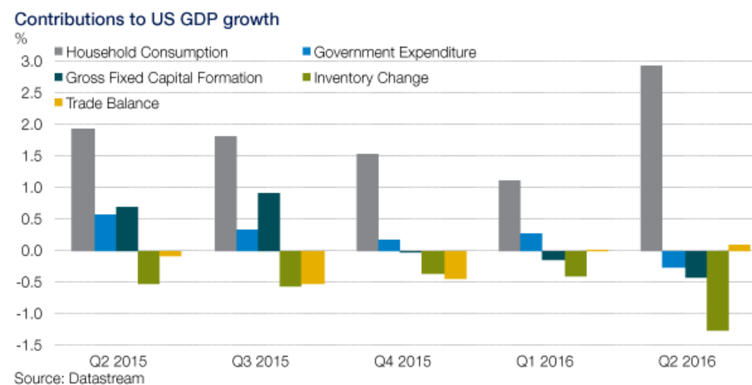
Eurozone activity was solid in the first half of 2016 and remained resilient after the Brexit vote, but we think there are signs the region will lose momentum in the second half. Although German GDP growth surprised to the upside in the second quarter (+0.4%) after a strong expansion in the first quarter (+0.7%), it was mainly driven by net export while business investment was weak. With the strong contribution from net exports likely to fade, we expect to see more





moderate growth in the second half, amid resilience in household consumption. Although Spain also surprised to the upside in the second quarter GDP growth, the trend is softening. Meanwhile, France and Italy stagnated in the second quarter, with a weak outlook indicated by the sluggish PMIs. From this recent trend, we see a two-tier situation in the Eurozone – strong Germany and a weak periphery.

However, Germany's domestic activity is unlikely to be strong enough to lift the rest of the region. Given the more cautious outlook in the Eurozone in the second half, we think the European Central Bank (ECB) will be pressured to provide further stimulus.



Source: Datastream

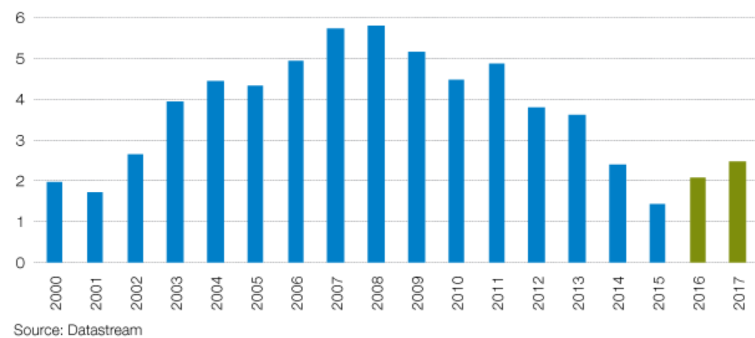
Across the Atlantic, we continue to see solid growth in the US. Although US second quarter GDP growth disappointed, it was mainly due to the drag from inventory change (which is often prone to reversals), while household consumption and employment growth remained robust. We believe the US economy will continue to display reasonable momentum and there is evidence that inflation pressure is building up gently. We think the disappointment in second quarter GDP growth is likely to take some pressure off the Federal Reserve (the Fed) to increase interest rates despite the rapid tightening in the labour market. A rate increase in September is highly unlikely, but we may see one rate increase after the presidential election, if the economy maintains its current momentum and barring no external shock either.

In the Far East, China's economic data disappointed and indicated a broad-based weakness in July. There is downside risk to growth in the second half, due to the softening property market, continued weakness in private investment, a sharp fall in credit and the waning effect of policy support. We believe the Chinese authorities will eventually resort to its usual tricks (i.e. further easing measures such as a boost to credit and infrastructure spending) to defend its growth target.

On a positive note, despite some growth concerns on China, there are signs that emerging markets as a whole are improving incrementally. We believe part of the pickup is a genuine improvement thanks to the recovery in commodity prices and export.

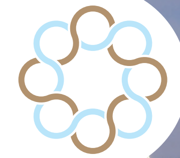
However, part of it is just less contraction in GDP growth (for instance, in Brazil and Russia) compared to last year. After all, emerging markets are likely to thrive against the backdrop of a more dovish US interest rates profile and softness of the US dollar.

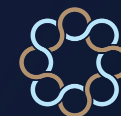
Overall, growth differential between emerging markets and developed markets is likely to widen this year after narrowing for the past four years – a key signal to be more optimistic in emerging markets.



(The chart shows the growth differential between emerging markets and developed markets).

First published 31st August 2016 by Janet Mui, Global Economist at Cazenove Capital Management.





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Level 2, Juxon House, 100 St Paul's Churchyard, London, EC4M 8BU
T: +44 (0)20 3102 7730 **E:** enquiries@finurapartners.com **W:** finurapartners.com