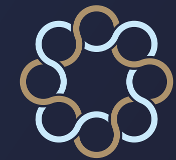
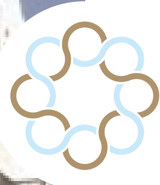


FINURA

PARTNERS

POINTS OF VIEW



MONTHLY COMMENTARY FROM PARMENION INVESTMENT MANAGEMENT

The FTSE World index climbed again in September with a rise of 1.2% in sterling terms. Year to date central banks around the world still appear willing to do what it takes to generate growth, and avoid recession and deflation.

Politics remains important; the new government in the UK is now 100 days into its term, there are elections in Europe to look forward to, perhaps influenced by the Brexit vote, and finally this month the first debate between the US presidential candidates took place. The last quarter of 2016 will be interesting to say the least.

United Kingdom

Despite some bearish forecasts that the UK economy faced an imminent recession post the Brexit vote in June, so far the UK economy has proved resilient. Consumer confidence has held up and this is reflected in good retail sales. No doubt the fall in the value of sterling has helped overseas earners in the FTSE100 (overseas earnings account for three quarters of earnings). However it still remains unclear whether the UK will negotiate for a "hard" or "soft" exit from the European Union, and therefore at the moment it is difficult to have an opinion on the longer term consequences of the vote.

In the meantime investors can only focus on the economy performing in the present. At the fund level the resumption of trading in some property funds is welcome. Post the June vote many property funds suspended dealing as redemptions could not be met from the cash available. Sufficient cash has now be raised from the sale of properties anecdotally not at distressed prices.

United States

At the turn of the year investors expected four small rate rises by the end of 2016. That has not happened. Last month the Federal Reserve again did not raise rates although three members did vote for a rise. It appears more evidence is needed that the economy, in particular jobs, remains on a sustainable growth path. Although the chairman Janet Yellen said the decision not to raise rates did not reflect a lack of confidence in the economy and the case for a rate rise had strengthened, the Fed want the jobs market to improve further before finally making a decision. Thus all eyes are now on the December meeting, a full year after the first rise.

Japan

Japan has always been at the forefront on using monetary policy to generate growth and inflation within its economy. In September the Bank of Japan announced it was going to target interest rates, in particular not to allow 10 year rates to fall below 0%. The new policy is called "yield curve control" and it is an attempt to make longer interest rates higher than short term rates. This should enable banks to lend as they can borrow cheap short term monies, and then make loans for longer periods and charge a higher interest rate. Elsewhere the news was not encouraging.

Looking at the broader economy, prices fell for straight six

months and households spent less. The strength of the yen this year has not helped by reducing import prices and company profits, making the 2% inflation target harder to achieve.

Emerging Markets

The above asset class has been the best performer year to date. The bounce in commodity prices this year has helped along with a less volatile dollar. The recent announcement of OPEC to reduce production has also boosted oil prices, the first such agreement in 8 years. Again some concerns were raised over the Chinses banking system during the month.

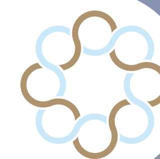
Since the financial crisis of 2007/08 the Chinese government has bene trying to maintain growth in the economy resulting a growth of credit/loans. Much of that lending has not been productive and the banking system is at risk of large defaults. Some banks have now begun to raise capital to bolster their balance sheets. Elsewhere, the economy continues to progress, retail sale continue to grow at over 10% per year and industrial production at 6% per year. Plus the economy continues to move way from manufacturing towards services.

Europe

So far there does not appear to be much contagion from the Brexit vote. More recent news has been dominated by the travails of Deutsche Bank and an impending fine from the US authorities re. a mis-selling scandal. Combined with the woes of Volkswagen, two of the largest stalwarts of the German economy may dent confidence in the economy. Meanwhile euro area inflation reached 0.4%, still way below the target of 2% but the best figure since 2014. Consumer and service sector confidence also improved in the month. Looking further ahead general elections in Germany and France in 2017 may provide political uncertainty and provide some volatility to the markets in the final quarter of the year.

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

First published on 6th October 2016 by Simon Brett of Parmenion Investment Management.



KEYNESIAN VS. MONETARISM

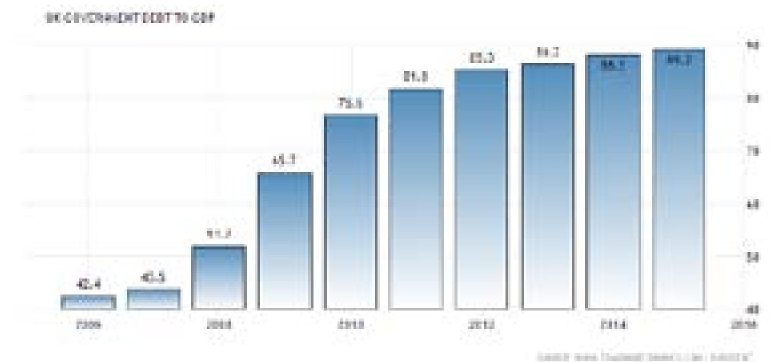
There have been two schools of thought in the history of economics; Keynesian and Monetarism. The former rests on the belief that government actions can determine growth in the economy, spending money on say infrastructure projects when demand is slack and reining back once the economy picks up. Monetarism on the other hand believes the amount of money in the economy determines activity and in particular inflation. Should a government print too much money inflation will rise, control the creation of money and a government can control inflation.

In recent years however we've witnessed Quantitative Easing (QE); the large scale printing of money by a number of central banks. For example the Bank of England has initiated £435bn of QE and yet why hasn't the UK achieved its target of 2% inflation? (CPI was stubbornly low at 0.6% in July 16). The answer is that the money injected into the economy, has rarely circulated beyond banks and pension providers and thus critics argue has only served to inflate asset prices.

Another novel idea has been the introduction of a Negative Interest Rate Policy (NIRP). An unconventional theory whereby nominal interest rates are set with a negative value, thereby imposing a cost on depositing money with banks, which therefore should increase spending? Unfortunately, efforts within Denmark and Sweden in 2010 and 2012, as well as by the ECB in 2014, have shown this policy appears to be ineffective as investors instead switch to hoarding cash by other means, such as safes or safety deposit boxes, which only leads to increased crime!

Given the above policies have only generated lack lustre growth many are now talking about Keynesian economics, which focuses on aggregate demand and theorises that you can increase economic output in the short run by increasing consumer spending, corporate investment or government spending. In effect, this is a loosening of fiscal policy, either via increasing spending or through reduced taxation which has to be funded through another source.

If the government is facing annual deficits and mounting debts (especially since the bailouts of banks in 2008/09), then how can you afford to loosen fiscal policy?



Of course, the government can delay plans to reduce debts in the future, but is this really achieving the objective of boosting the UK economy?

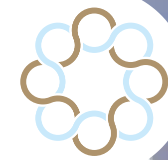
The answer, rather bizarrely may actually lie in the combination of both fiscal and monetary policy. In August 2016, the Bank of England announced an additional £10bn which is to be used to fund corporate debts which should boost employment and investments. The reality however is that corporates could just use lower debt rates to finance an increasing cash mountain or just return excess cash to shareholders. Is this any better than Government bonds?

A different approach could be to directly finance the UK consumer, who's spending makes up the vast majority of output within the UK economy. Increasingly known as 'helicopter money', this concept was originally proposed in 1969 by Milton Friedman and rather than relying on these funds to 'trickle down' from banks or corporates, the BoE could instead just 'drop' money on the UK consumer (hence the helicopter reference) or use monetary policy to reduce taxes.

Is this the future of monetary policy? In effect, the combination of both Monetarism and Keynesian could directly stimulate the country, but in doing so it would dramatically increase the quantity and circulation of money, which could raise inflation beyond the UK's 2% target. This could potentially raise tricky questions for the Bank of England and isn't this ultimately a political question?

When the future of central bank policy is unclear and markets are being driven by central banks, politics and currencies, it seems more important than ever to have a truly diversified portfolio to mitigate external shocks. If you would like further information on how we manage risk in your portfolio, then speak to your relationship manager today or call a Parmenion representative on 0845 519 0100 and we will be happy to assist.

First published on 9th September 2016 by Andrew Gilbert of Parmenion Investment Management.



PERMANENTLY LOW INTEREST RATES MAY BE THE PROBLEM NOT THE SOLUTION

In the immediate aftermath of the last recession and accompanying financial crisis, there was every reason to expect companies to be reticent about embarking on long-term, productivity-enhancing investment programmes.

Moving the story on, we are now seven years from the end of the recession, and it remains the case that productivity growth in the larger western economies remains very weak. The corollary of this, which can be seen very clearly in the US, Germany and the UK, is that the rate of job creation accompanying relatively dull growth has been exceptional. In turn, this has seemingly created a policy dilemma for the US Federal Reserve and for the Bank of England (less so for the European Central Bank, which is more focused on deeper problems in southern eurozone economies) – should the direction of interest rates be influenced more by growth trends that are considerably weaker than those achieved prior to the recession, or by progressive tightening in labour markets that can be expected to lead to higher wage inflation? The seemingly counter-intuitive answer is that for many western economies to improve their growth potential, interest rates should now be pushed higher.

To an extent, this policy/growth dilemma can be resolved by the observation that growth in many economies in the decade or so prior to the recession was unsustainably fast – and that current growth rates can be considered more normal. But this 'normal' epithet is based on longer-term achieved rates of productivity growth. The rate of growth that an economy is capable of sustaining is based on achievable gains in productivity, adjusted for changes in the size of the workforce and employment rate.

In what follows, we will focus on the UK, but the conclusions can be more widely applied. Prior to the recession, the UK's long-term average annual improvement in productivity was around 2.0%. During the period of uninterrupted growth between 1992 and 2007, the annual rate also averaged 2.0%. This can be compared to an average GDP growth rate of 2.8%. The difference can be attributed to an expansion in the size of the working population (some of this as a result of immigration) and also to an increase in the employment rate. Looking ahead, official projections suggest that the size of the workforce (including all adults of working age) will increase by around 0.25% per annum. Given that the employment rate is already at an all-time high, it seems unlikely that it will rise appreciably higher. So, if the UK economy were able to achieve productivity growth in line with the long-term average, the achievable annual growth rate ought to be around 2.25% per annum, which is slightly above the 2.0% that has been averaged since the recession.

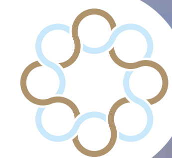
So, no problem? Well, there is a problem: the 2.0% average growth in GDP recorded over the past seven years has been supported by a growing working population and more significantly, a rising employment rate. The associated productivity improvement has been a meagre 0.8% per year. This situation is also evident in the US and Germany – that

productivity growth is contributing to GDP growth at half the rate that might have been expected. The issue is clear: if productivity growth does not improve, then even the current comparatively dull growth rates will prove unsustainable. And without productivity growth, those in employment will find it increasingly difficult to achieve real increases in wages and salaries.

So, why are companies not undertaking productivity-enhancing capital investment? Conventional economics would suggest that at very low interest rates, companies ought to be encouraged to borrow for investment purposes. I believe that this is not happening because there is no competition for capital between asset classes within the economy. Through the associated monetary policies of exceptionally low interest rates and quantitative easing, central banks have added huge amounts of liquidity into the financial system and simultaneously forced down interest rates and longer-term yields along the yield curve. They have also made the process of lending much less profitable and undermined the process of creative destruction. Companies normally have to compete for investor capital, partly because dividend yields are usually lower than bond yields. However, with dividend yields above bond yields, there is no pressure on companies to compete for investor attention by growing profits. Hence, there is no pressure on them to embark on productivity-enhancing investment.

In any system, the process of challenge is vital to performance, but when interest rates and yields are below core inflation, this is absent. In effect, therefore, low interest rates induce economic laziness. So this is the paradox –by causing structural mispricing of government bonds and by holding interest rates exceptionally low, central banks are actually undermining economic dynamism and growth. This conclusion seems to be supported by what has happened in Japan over recent decades (albeit, Japan's problems have been exacerbated by demographic issues). While it has had the lowest interest rates over the past few decades, it has also achieved the lowest productivity gains when compared to the US, Germany and the UK.

First published 30th September 2016 by Cazenove Capital Management.



SIX TIPS TO CONSIDER WHEN REVIEWING YOUR FINANCIAL PROTECTION NEEDS

Living a healthy lifestyle and being in good health is something that the majority of us aspire to. We are often encouraged to look after ourselves by maintaining an active and healthy lifestyle.

However, one thing that is certain is that despite our best efforts, falling ill can happen to anyone at anytime, with little or no warning, Hilary Clinton's recent diagnosis of pneumonia proves exactly that.

Being diagnosed with a life threatening illness can turn people's lives upside down. It can shake a family's security, impact on the ability to work and quickly affect the stability of finances; being financially prepared and having given serious thought to how the family's finances will be affected can make a big difference.

We believe that in taking care of our health, we should also take care of our finances; protecting what we have got, and insuring our lives or health. In other words, a back-up plan in case we have to face the sad fact of a premature death or life-threatening illness. Should a partner, father, mother or child fall ill, it could provide the money for life to continue in the best way it can. This could mean being able to afford to take time off work to recover, or care full time for the patient, or to pay off a mortgage on a home to reduce your expenditure.

Life insurance and critical illness cover are two types of insurance policies which can offer financial protection to a family should serious illness become an unwelcome part of life. They are similar in that they both generally run for a set number of years, for a set sum assured and for a monthly premium agreed at outset.

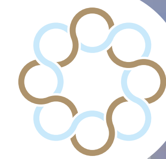
While a life insurance policy will pay out in the event of the death of the person whose life is assured; a critical illness policy however will pay out in the event of the person who is assured being diagnosed with one of a list of specified illnesses. This may include for example, heart attack, major organ transplant, some cancers or multiple sclerosis.

With this in mind, here are six tips to consider when reviewing your financial protection needs to get you to thinking - before you actually need it:

- Did you know that life insurance can be set up in order to provide your partner with an income? Family income benefit can be a solution to replacing your wage if you die, paying a tax free lump to your partner for a chosen term, such as until the children turn 18.
- Life insurance and critical Illness cover is not just for a working partner. If your role is as a stay at home parent or a full time carer then you should consider this contribution in financial terms. Would your partner be able to afford child care and home help costs if you became ill or died? Or would you if it was your partner who died and you needed to return to work?

- Did you know that critical Illness policies often protect your children too? Some policies will pay policy holders a pre-determined sum should their child become ill. This allows parents to take time off work to care for their child or provides the cash to adapt a home if needed.
- If you arranged your life insurance some time ago, then it may be that you can arrange a new equivalent policy today which is cheaper. Maybe you were a smoker at the time, but have long since given up? It is more complicated with critical illness cover, as any illness you have had since taking out the policy may be excluded with a new policy bought. Speak to a financial planner who will be able to provide you with a new quote and advise on the best course of action.
- Check how much you are insured for (the sum assured). It could be that since taking out the policy, your financial commitments have become greater with more debts and children. Not having enough life insurance in place can leave your family vulnerable. Increasing your sum assured may cost less than you think, but provide some valuable peace of mind.
- Remember to tell the truth. If you die of lung cancer caused by smoking a packet of cigarettes a day, but you have told your insurance provider that you don't smoke, then your policy is extremely unlikely to pay out; be open and honest when talking to your financial planner and applying for any policies of this kind.

First published 23rd September 2016 by Sanlam UK.



BUMPER UK RETAIL SALES IN JULY AS CONSUMERS SHRUGGED OFF BREXIT GLOOM

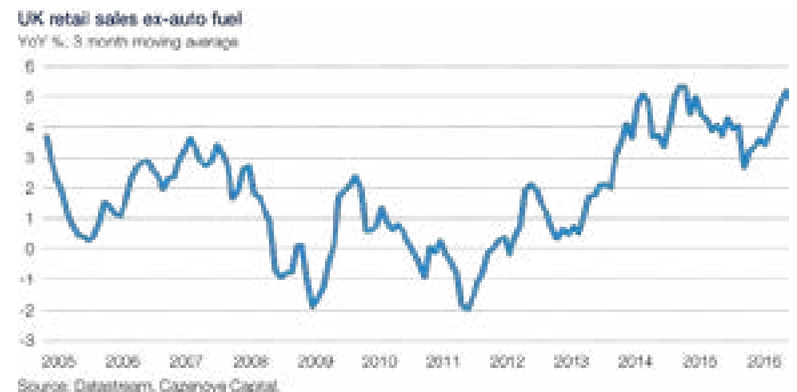
The bumper UK retail sales figures for July and another solid report for August showed that shoppers were undeterred by Brexit uncertainty, contrary to the implications of appalling survey data in the immediate aftermath of the referendum.

Core UK retail sales volumes (which exclude auto fuel) were up 1.7% over the two-month period; compared to a year earlier, core volumes were up only fractionally less than 6% and by over 6% including auto fuel. Most categories showed good momentum, although clothing sales were distorted by weather patterns. While the surprising strength in the data was partly attributable to warmer weather and discounting, it still provided comfort with regard to total household demand.

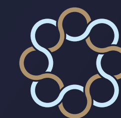
While we acknowledge that UK retail sales are volatile on a monthly basis, the three-month trend has been improving since the start of the year. The marked expansion in retail sales in July was consistent with the British Retail Consortium (BRC) retail sales numbers released a week earlier. BRC retail sales were up 1.9% year-on-year (YoY) in value terms and +3.5% YoY in real terms in July, which was the biggest gain in six months. Also, the high-frequency John Lewis weekly sales report, which is a good proxy for the trend in middle-class spending, has remained resilient and has shown no discernible referendum impact. Furthermore, the UK services Purchasing Manager Index (PMI), an activity indicator of a sector that represents almost 80% of the UK economy, rebounded markedly in August, back to pre-vote levels.

Further good news for the near-term outlook for the UK high street includes the recovery in the UK GfK measure of consumer confidence in August, having plummeted in July. All sub-indices including future and present financial situations, current and future economic conditions and major purchase indices rebounded. Interestingly, the Savings Index fell sharply, suggesting that consumers have shrugged off Brexit uncertainty and prefer to spend, and also, perhaps, that they have been influenced by the August cut in interest rates.

On the basis of this evidence, it is increasingly likely that the UK will avoid entering a recession. Going forward, the road may be bumpier, but a favourable macro backdrop for consumers, including a tight labour market and high levels of job vacancies, should remain supportive to overall activity.



First published on 16th September 2016 by Janet Mui of Cazenove Capital Management.



FINURA

PARTNERS

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