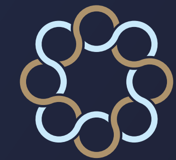

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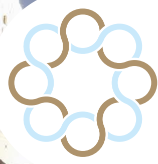
# POINTS OF VIEW



# IS REAL ECONOMIC GROWTH ENOUGH TO PUT AN END TO QUANTITATIVE EASING?

**Almost exactly 10 years ago, the world woke up to what is now considered to be the worst financial crisis since the Great Depression of the 1930s. A decade later, and we're still feeling the effects of the so-called credit crunch, not least the lasting impact of unprecedented levels of monetary stimulus exerted on the global economy.**

By artificially flooding money back into the financial system, central banks kept interest rates low, and the global economy above water. Ten years on, and we're finally seeing signs that the central banks are positioning themselves to move away from their loose monetary policy, giving way to a more normal environment of higher inflation and higher interest rates.

Here is our view of what is to come:

### The US

The US Federal Reserve (Fed) is currently setting the roadmap for withdrawal from monetary stimulus, and other central banks are watching with interest. The Fed announced that it would reduce the number of bonds it holds (bonds it bought to support markets in the global financial crisis), which will ultimately nudge up bond yields. Meanwhile, it will maintain the gradual pace of interest rate hikes, tightening monetary policy in a predictable fashion.

Slightly contradictorily, it looks set to pause its series of interest rate increases in September, with a view to resuming them again in the first quarter of 2018. This is in order to gauge the impact the change in bond holdings has on markets.

### Europe

Monetary stimulus put in place by the European Central Bank (ECB) had the desired effect – encouraging global investment, and holding the Eurozone together. Today, there's renewed economic confidence in Europe, and the ECB has tentatively nodded towards a less accommodative monetary stance. We're expecting it to end, or taper, its quantitative easing when the current programme concludes towards the end of the year. Stronger economic data is making low interest rates harder to justify, and the ECB will eventually have to move them higher (albeit from a negative starting point).

An easing of monetary stimulus is a vote of confidence for Europe, and should not be too disruptive - initially at least.

### The UK

There's no question the UK is in a difficult position and we were very surprised that the Bank of England (BoE) appeared to be seriously considering raising interest rates from their current levels. With the Purchasing Managers' Index (an indicator of the economic health of the manufacturing sector), and consumer data at disappointing levels, the case for higher rates appears low.

Indeed, we believe there will be weak economic growth in the UK for the foreseeable future and this was reflected in

the anaemic 0.3% growth rate for the three months to June this year. Brexit fears are stalling investment, government expenditure is already higher than tax receipts, and wages after inflation have been falling, leaving the consumer with reduced spending power.

All of this means that the BoE will struggle to make any significant moves away from monetary stimulus, although we must remember that its mandate is to maintain inflation at 2% rather than achieve economic growth.

***"Global growth is likely to remain strong, with the US, Europe and China showing reasonable momentum. Global unemployment levels are generally low, and we are seeing higher levels of wage inflation, although this is somewhat moderated by the supply of discouraged workers returning to the workforce, in particular in Europe." - Philip Smeaton, Chief Investment Officer***

**The weakening of the US dollar**

Our predictions for the US economy have played out as expected. The US was the first to increase interest rates, which led to massive demand for the dollar, ultimately driving up its price. It soon became over-priced, and has now fallen about 10% since the start of the year, although we still consider it to be expensive.

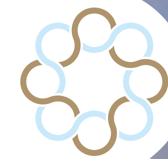
This fall in the dollar lent support to emerging markets that sell commodities priced in dollars, and often have dollar-denominated debts. It also supports the earnings of US-based multinational companies that are now able to translate foreign earnings into more dollars.

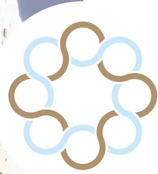
We have been cautious of investing in US companies, which has worked well this year. If the current trend of US underperformance persists, we will become more comfortable to increase our investment in the region.

Source: Bloomberg

***"Our underweight position in US stocks has benefitted client portfolios year to date, as the US has underperformed global indices by over 6%. We will continue to hold this underweight position as we are still concerned that the US is particularly expensive." - Matthew Brittain, Investment Analyst***

First published on 4th August 2017 by Sanlam UK.





# THE UNCONVENTIONAL BECOMES THE NORM

**It started with an unconventional recession, one that emanated from a near collapse in the financial system but which, in some larger economies, resulted in a comparatively modest increase in unemployment. Then we had unconventional monetary policy, encompassing injections of liquidity and exceptionally low interest rates. Now we seem to be in an era of unconventional political consequences.**

Electorates in many western countries are questioning the established order, as we saw in the outcome of UK referendum on EU membership, in the results of elections in the US, France and the UK, and in the general increase in support for anti-establishment political parties. There is a growing frustration that, while economies have been recovering, the benefits of growth have not been feeding through to real incomes.

The cause of this stagnation is not too hard to determine. There is a feature of the recovery that has been and remains common to most advanced economies – low productivity growth. Behind this, there has been a persistent lack of productivity-enhancing capital spending, so that although unemployment has fallen very quickly in relation to achieved growth rates, the incomes of average working people have been almost static in real terms.

The challenge facing advanced economies is to move onto a stronger investment-productivity path. Implicit within forecasts for the US economy for the past three years has been the assumption that this was imminent. Such hopes were disappointed in both 2015 and 2016, and it would seem that 2017 is set to be another year of high expectations dashed by reality. For the EU, prospects are slightly better, with momentum gradually picking up.

**Reasons to be cheerful**

The UK is facing additional challenges. Eventually, we believe that the Brexit process will encourage capital spending as companies with less easy access to EU labour prepare to expand into new markets. However, it may take time, particularly against the backdrop of increased political uncertainty. This is also true of the positive trade impacts that should result from the drop in the pound. More obviously, households are being tested by the inflationary consequences of higher import costs and the squeeze on real income growth.

These contrasting forces on economic activity make the likely growth rates for the UK over the next two years difficult to assess, but we believe many commentators are understating the positives.

With Japan still struggling to engender stronger core growth, the implications of current trends for advanced economies are clear: growth is set to remain dull. As a result of the more temperate expansion in demand in developed economies,

emerging manufacturers, commodity producers and others that had previously thrived on exporting to the developed world will also continue to see unexciting growth.

The second quarter of 2017 has seen a further grind upwards in equity markets. European equities were the star performers in sterling terms. The US market performed well in local currency, but a weak dollar was a drag to sterling returns. The Asian and emerging markets continued their positive performance. The UK equity market was the laggard as the general election had a clear impact on sentiment.

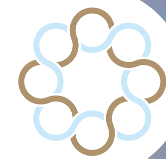
There was a divergence in performance of different sectors, as weaker inflation and lower commodity prices caused the underperformance of financials and resources, while technology, healthcare and defensives performed very well.

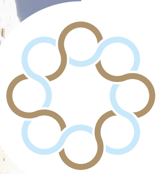
Given the apparent rolling over of inflation in the US, government bond yields fell a little, giving small positive returns to investors, while high yield and investment grade credit spreads continued to narrow.

**Looking ahead**

We believe that the backdrop of global growth will be positive for equities in the second half, but our neutral positioning is predicated on valuations that are no longer cheap, and our view that the central banks will begin to reverse quantitative easing. Our fixed-income positioning continues to have a preference for index-linked securities.

First published on 17th July 2017 by Caspar Rock, Chief Investment Officer, and Richard Jeffrey, Chief Economist at Cazenove Capital.





# HOW TO HELP YOUR CHILDREN ONTO THE PROPERTY LADDER

**Over the last few decades, the divide between the 'haves' and 'have-nots' of home ownership has grown deeper, and wider. Indeed, it's hard to open a newspaper without reading a feature about the woes of the first-time buyer, versus 'smug' baby boomers and buy-to-let landlords.**

It's easy to see why they might be feeling disillusioned. The average age of a first-time buyer in the UK is now 30 years old, with an average deposit of £34,000. This increases to 32 years old, and an average deposit of £96,000 in London. *

Market forces continue to conspire against them. Research by Saga has shown that the older generation are less inclined to down-size thanks to the cost of moving, and the lack of suitable property to move to. And, although the Government has made tax changes to dis-incentivise property investors, low interest rates and buoyant rental yields have meant those investors are yet to feel the bite, and are carrying on regardless. House prices remain strong due to a severe shortage of housing in the UK, especially in the South East and London, and it could be many years before this imbalance is addressed.

The Government has tried to introduce schemes to encourage first time home buyers onto the property ladder, but it's increasingly coming down to the 'Bank of Mum and Dad' to provide the necessary deposit for their children to purchase their first home.

## So how can parents help first time buyers?

### Gifting deposits

You can gift your child the deposit (or even a home if they are incredibly lucky), but be very careful of inheritance tax (IHT) rules. If you die within seven years of the gift, your child could be liable to pay the IHT bill, which is 40% of the value of the gift.

### Lending money

You can lend your child money but it makes sense to do this formally. A 'deed of trust' can be drawn up by a solicitor when the money is given. This sets out how much you've contributed, how you will get it back, and when. If you charge interest on your loan, consider setting up a formal repayment schedule using a solicitor's 'promissory note'.

### Guarantor mortgages

You can guarantee your child's mortgage debt, which means you will have to cover any payments that are missed, and could be liable for a full repayment if your child consistently defaults on the mortgage. Guarantor mortgages can take both yours and your child's income into account, potentially meaning they need less deposit, and can borrow more. You can also use your home as collateral; securing a charge against your property instead of your child putting down a large deposit.

### Family offset mortgages

You can put money into an account linked to your child's

mortgage. This money is then deducted from the mortgage, reducing your child's repayments. There are drawbacks though - your money will be locked away until the mortgage has been paid down to between 75% and 80% of the property's value and, in the meantime, you won't receive any interest on your savings.

**Family deposit mortgages**

You can deposit cash with a lender, who then holds it as security rather than asking for a larger deposit. The money is held in a savings account, which earns interest for a pre-agreed term – usually three years. Provided your child maintains the mortgage payments, your money is returned to you with interest added.

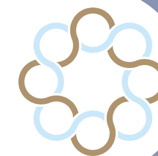
It makes a lot of sense to help children get onto the property ladder. It can even help your inheritance tax planning. But it's also a complex business, and must be done properly. We highly recommend you take professional advice from a mortgage adviser and tax planner before doing anything.

Sources:

Homesandproperty.co.uk

Saga

First published on 6th July 2017 by Graeme Sturt, Mortgage Planning Director & Senior Wealth Planner at Sanlam UK.



# ARE MARKETS UNDERESTIMATING GEOPOLITICAL RISK?

**Every week it appears that North Korea tests a missile that falls safely in the Sea of Japan. Saudi Arabia and its close neighbour Qatar are having a spat about terrorism funding, could they come to blows and what would that mean for the oil price? Should we worry about such events? And how will it affect our savings and investments?**

Such heightened risk events are perhaps more frequent than we think, and yet stock markets have often climbed in the face of such events.

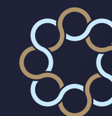
Going back to the 1990s and the disintegration of Yugoslavia is an example of such stock market climbs. Various wars took place on the doorstep of Europe between 1991 and 2001, and Yugoslavia was a country where many used to take their annual holidays. After the death of Tito the various separate regions split and established their own countries, and yet from a stock market perspective, the 1990s were a period of bull market returns culminating in the dot.com boom. So we can assume that stock markets never saw this particular crisis as a major risk.

More recently the Iraq war started in March 2003 also saw a period stock market rises. In 2004 the FTSE All Share actually rose by approximately a third. During the period between 2000 and 2009, the stock markets reeled more from the fall out of the tech bubble and the Great Financial Crisis than any conflict.

Severe geopolitical events, and in particular their fall-out, are hard to predict and take the time to unravel. If they lead to a collapse or disruption to world trade then that will feed through to corporate profits, and thus the expectation that stock markets will suffer.

Both of the events described above did not appear to hinder economic growth. However, the global financial crisis may have had even more serious consequences than it did for stock markets if liquidity had completely dried up without the intervention of central banks and quantitative easing.
Keep aware of possible geopolitical events by all means, just realise the outcomes are very hard to predict.

First published on 11th July 2017 by Simon Brett of Parmenion Investment Management.



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