QUARTERLY MARKET COMMENTARY

Mrs May´s general election announcement on the Tuesday following the Easter weekend ranks as one of the closest kept political secrets for a very long time. Not a whisper. No hint of a leakage to the press or anyone else. She stepped out of the front door of Number 10 to declare her intention to go to the country despite being only two years into the current five year fixed term Parliament.

521 other MPs, even Labour ones, agreed with her in the subsequent vote, easily achieving the two thirds majority required to allow an election to proceed.

The UK´s membership of the EU lapses automatically in March 2019 on the second anniversary of our giving notice to quit. It remains a moot point as to whether negotiations of our divorce from, and future relationship with, the EU will be complete by then. While the result is not a foregone conclusion, were the Conservatives to be re-elected, there would be no need to hold the next election until June 2022, thus buying the Government another two valuable years in which to try and achieve as smooth an economic, legal and financial transition as possible.

Were they to be returned with a bigger majority than the current 17 seats, as the polls have been suggesting is likely (but polls are fallible, as we know!), stronger domestic political backing ought to give Mrs May greater authority with regards to our position when negotiating with the EU. She would more confidently be able to focus on the job in front of her without having to worry so much about what´s going on behind, particularly among her own MPs.

From an investment perspective, markets responded positively to the news, especially on the foreign exchanges where sterling has strengthened from $1.24 to $1.29. However, some of this ground has since been given up, especially against the €, when the second round in the French Presidential election confirmed that Emmanuel Macron was to be the new President. With completely opposing views on the EU and Brexit, compared to Marine Le Pen, the outcome was of relevance to the UK. Macron, a staunch Europhile, has made it clear that the UK must not be winners from Brexit. A Le Pen victory, on the other hand, would have been a great ally given it was her agenda to achieve `Frexit´ for France.

For investors, a Macron win would essentially be little different from the status quo, possibly with some relief for the €. However, with French political risk abating and a further divorce from the EU avoided, attention will now turn to Germany and the federal election on 24th September. Unless anything dramatic happens in the meantime, this one has all the appearances of a straight fight between the incumbent Christian Democratic Union (CDU) party under Angela Merkel, and Martin Schulz´s Social Democratic Party (SPD) both of which have significant clear water, more than 20 percentage points, between them and the flotilla of minor parties trailing in their wake. However, the minor parties are important to consider in the event of a close result and the possibility of a coalition government.

Both Merkel and Schultz are taking a hard line on Brexit, perhaps not surprisingly given the home audience they are appealing to in their election campaigns. But after the election? Were Merkel to win again would she then take a more pragmatic stance, not least because the UK is Germany´s largest export market in the world for cars, accounting for 20% of all German automobile production?

Schultz on the other hand is an ex-president of the European Parliament, a committed subscriber to the European project; he´d be less likely to be flexible, one assumes.

Turning to economics, the first quarter data suggests a global economy that remains in quite reasonable shape, albeit still with much too much debt sloshing around the system. Growth in developed markets has been better than was projected this time a year ago. On the other hand the inflation rate is certainly higher than a year ago (zero then, around 2.5% now) but is showing signs of stabilising, especially given that commodity prices have been travelling sideways for several months. Taking crude oil as an example, it has barely traded outside a range of $50-58 per barrel since December after recovering sharply from its trough of $28 in January 2016. That is not to be complacent about inflation, however at least it is no longer accelerating at the rate some economists were estimating towards the end of last year.

In the US, the possible implications of a Presidential impeachment has abated although ongoing investigations still prevail. Economically, the US is in good shape, with solid growth numbers, a strong housing market, improving consumer sentiment and robust employment numbers. In April alone, the US economy added 200,000 jobs to US non-farm payrolls, taking the unemployment rate down to 4.4%, a 30 year low. The consensus now is for a further rate rise this month and two more rate rises this year.

In Europe, the current fiscal stimulus packages now appear to be providing support to the region with very good economic growth numbers, strong Purchasing Manager Index (PMI) readings and inflation coming through since the deflationary period experienced in the last quarter of 2015.

Japanese and Emerging markets have continued to perform well, highlighted by strong capital inflows. The Emerging Market region especially has benefited in recent months from US $ weakness, which is largely beneficial to commodity biased economies.

In Japan, economic and social reforms, together with a stronger framework for corporate governance is providing a backdrop for corporate profitability to rise.

As a result of the above, most stockmarkets have been rather resilient to any bad news and indeed most developed stockmarket indices have recently hit new all-time highs. That said, despite the good gains made by most stockmarkets in recent months, significant political and economic headwinds prevail. This includes any further announcement on US trade and protectionism by President Trump, such as the recent decision for the US to remove itself from the Paris Agreement, or a more concerned view on Chinese debt. The Chinese debt to Gross Domestic Production (GDP) ratio now stands at 210%, which is higher than Korea's level ahead of the 1997 Asian crisis and approaching the level accumulated by Japan in 1989 when the deflationary period began. As a result, Moody's, a leading credit agency, downgraded China but many believed the agency overreacted and wanted to appear in control, following very high criticism it received in failing to identify the issues in 2008.

As we have recently stated, Central Banks appear ready to intervene and provide stimulus if they feel it is necessary but the view is that monetary policy is tired and fiscal policy is now required by governments. Accordingly, the results of their action and the longer term impact of such action is becoming more difficult to comprehend. In our view, it is more important than ever for medium to long term investors to maintain a diversified portfolio in order to benefit from market rises when they happen and to dilute volatility in the event stockmarkets fall. It is impossible to predict when markets will fall and rise but, in general terms, a sensible investment strategy involves riding out market volatility.

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