QUARTERLY MARKET COMMENTARY

As another year draws to a close we take a look back over the main political and economic events of 2018 and what 2019 might bring.

Well it certainly has been an interesting year for those who follow politics and economics.

On the political front, we have witnessed a wide array of political environments with modest, almost hum-drum, mid-term elections in the US being overshadowed by the events in Brazil, Italy and of course, the UK.

In Brazil, Jair Bolsonaro, the presidential front-runner was stabbed at a political rally but then went on to win the election and become President. Bolsonaro is seen as a key support to business and economic reform and as a result, Brazil's currency and stockmarket has been strong, comparably to other currencies and markets, on the back of Bolsonaro's election win. It has also prompted some to conclude that a period of stability might prevail in the largest South American country but that may be some way off for a region so clouded in corruption, scandal and previous presidential impeachments.

In Italy, we saw a prolonged period of political uncertainty until a coalition government was formed between the 'anti-establishment' Five Star Movement and the 'anti-immigration' League. Many viewed it as an odd-couple coalition but it certainly has not been the first time political parties have joined forces to seize and retain control. The UK Conservative Party and the DUP perhaps?!

The Italian election was, and still is, considered by many as a significant risk in political and economic terms. Italy is perhaps not well known for playing by the rules and certainly does not like the prospect of possibly being dictated to and threatened by outside influences. The coalition government was formed at a time when the country's national debt was worth 132% of GDP. That is the worst in the Eurozone, bar Greece. The populist coalition presented its budget, which showed they wanted to cut taxes and spend more money. This would have resulted in Italy's deficit rising from just 1.3% to well over the 3% ceiling that the EU wants its member countries to stick to. Although a revised budget has been considered it will still result in borrowing and deficit numbers exceeding the limits. It does seem that the Italians do not want to play by EU rules!

In the UK, we have of course, been witness to the ongoing saga that is BREXIT. Despite Theresa May agreeing a deal with the EU, it is very clear that large swathes of the deal do not sit well with Labour, the DUP and even members of her own party. At the last count, it was estimated that over 90 Conservative MPs and the 10 DUP MPs will be voting "no" to the deal when parliament votes on December 11th. It seems many are concerned over the transition period and rules, including the Northern Ireland border and immigration. The very recent vote for the legal advice Theresa May received to be made public is likely to see the motion defeated. In this scenario, it is likely that the UK will a) be forced to try and re-negotiate the deal and possibly delay Article 50 b) leave the EU with no deal and c) see Labour instigate a vote of no-confidence and possibly call for a second referendum. We are, of course, watching this space with interest.

It seems almost inconceivable that we have not mentioned the US and China trade disputes until now. We have discussed the details and impact of the US and China trade disputes in our June and September editions (available on The Goodman Partnership LLP website) and so we won't repeat this here. Nonetheless, the recent G20 summit in Argentina resulted in the US and China agreeing a 90-day truce on further trade tariffs in order to secure a longer-term deal.

However, Donald Trump tweeted the following day that he remains ‘a tariff man’ and despite China officially saying they are ‘confident in implementing the trade commitments to the US’, it is clear that there is already some confusion over the words, tone and commitment from both administrations.

The US mid-term elections perhaps provided little excitement as the Democrats took the House of Representatives and the Republicans retained control of the Senate. However, perhaps one truth is crystal clear – that America is divided. This division is likely to infect US politics for the next two years and will only reaffirm globally that the US currently sits as the international ‘disruptor’.

It would be unforgiveable not to mention the tragic and abhorent murder of Saudi Arabian journalist Kamal Khashoggi in Turkey. The US Senate has recently concluded that Crown Prince Mohammed bin Salman ordered the killing and the US has now vowed to press forward on ways to penalise Saudi Arabia.

So, what about 2019 and what are we likely to see? Probably a lot of 2018 – but the risks are rising! The US and China trade war truce will end in March, the same month that the UK should officially be leaving the EU. What is clear is that much further discussion and agreement is required on both topics and it would be of no surprise if the first quarter of 2019 ends with more confusion and uncertainty than we have already seen in 2018.

As we have already mentioned, Europe and Italy will be in the spotlight next year. This is at a time when Mario Draghi, head of the European Central Bank, sees his tenure end. Draghi is considered one of the finest central bankers with his thoughtful and measured approach in trying to unite the fiscal and economic policies of the member countries of the European region. His departure comes at a time when the ECB will be undergoing Quantitative Tapering or an unwinding of economic stimulus and the Italians looking to end austerity in favour of spending. Italy also wants to see Euro-zone debt restructured so that all member states have levels of debt below 60% of their respective gross domestic product. This would probably suit Italy very well, given that Italy remains the largest issuer of debt to the ECB, currently standing at 400 Billion Euros and their overall debt levels to GDP is perhaps closer to 160% than 132% if all loans to the ECB were taken into account!

From an economic point of view, it is perhaps becoming clear that the landscape is changing from one of stimulus and ultra-low monetary policy to one of a ‘normalisation of interest rates’ and modest growth. Indeed, the consensus is shifting amongst wealth managers that after nearly 10 years of manufactured growth we could be seeing the beginning of the end of this particular business and economic cycle.

The economic statistics in the US seem to be indicating that ‘peak’ growth, unemployment and corporate earnings have already been surpassed. The growing debate around a flattening or inverted yield curve in the US, which measures the gap between short and long term borrowing rates on 2-year and 10-year Treasuries, is evident. This is considered one of the most accurate indicators of pending US recessions and the consensus now is that the US could enter an economic recession late in 2019.

However, history has taught us that stockmarkets have delivered good returns in the period leading up to a recession. As always, it is impossible to predict the future - especially whether stocks and shares will fall or rise. Therefore, it is important that medium to long term investors maintain a diversified portfolio to benefit from stockmarket rises when they happen and to dilute volatility when there is a fall. Our strong belief is that a sensible investment strategy involves riding out stockmarket volatility.

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