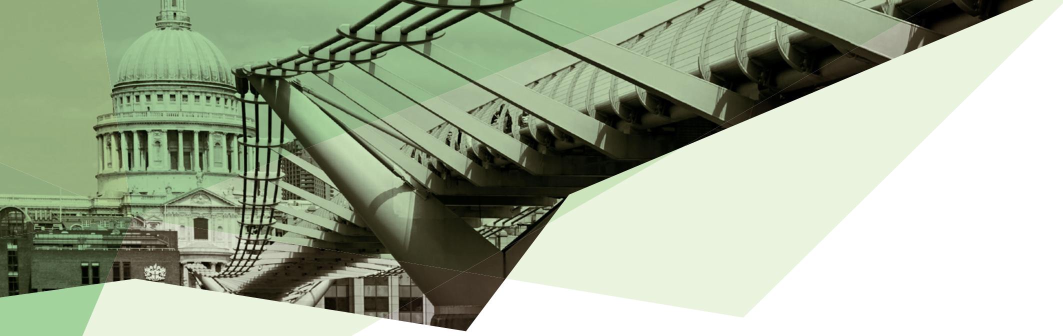


Investec
Wealth & Investment

View from the bridge

October 2019

Background

In our last quarterly Review, we noted that trade concerns and the deteriorating momentum of the global economy had dominated the headlines on which investors focused.

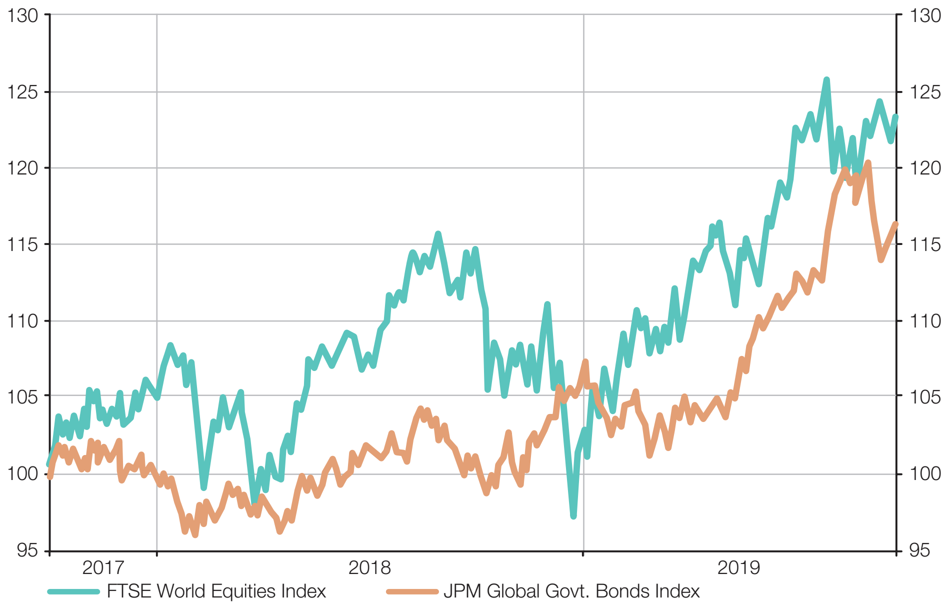
Three months later very little has changed, except that Central Banks in both the United States and Europe have loosened monetary policy and this approach has been adopted in a number of other countries. Each escalation in trade tensions prompted downward pressure on stock markets and contributed further to the state of uncertainty that has been shackling both corporate and consumer confidence for much of the past two years. Although investor anxiety was alleviated by Central Bank actions, the pattern of falling economic growth projections has not shown any such brightening. In part that is due to a well-appreciated belief that the lead time for economies to react to monetary policy stimulus is at least six months; indeed many economists think that this reaction can be even slower once interest rates are around zero.

Both the developed world and emerging countries have experienced this deterioration in growth forecasts and economists believe that the positive response to lower interest rates is unlikely to be felt in the remaining months of the current year. This leaves the prognosis for 2019 struggling to reach 3% global growth, compared with predictions of about 3.3% only three months ago. Such a slowdown is broadly spread between the advanced countries, where growth might be no more than 1.8%, and the emerging world where growth will prove less elusive but where the rate of just over 4% is still less rapid than was expected earlier in the year. Forecasts for 2020 have also been reined back, though the range of potential outcomes is wide and depends on when or if the tariff war between Mr Trump and other trading partners of the United States is resolved. Clearly it is in the interests all parties to achieve a resolution, but none will want to be seen to have conceded too much.

The resumption of looser monetary policy together with weakening growth forecasts and tensions around trade fuelled investor nervousness and drove sovereign bond yields to new lows during the quarter. As we cover in more detail under the next section on bond markets, European yields moved broadly into negative territory across a wide range of maturities and countries with (for example) investors at one point seemingly happy to pay the Swiss Government 1.2% annually for each of the next ten years for the privilege of lending to it. Though a little of such froth was blown off in the last days of the quarter, Government bonds in general outpaced equity markets and returns from global benchmarks for both asset classes were magnified by a further decline in sterling: the Brexit position showed no real signs of resolution and Boris Johnson, the newly selected UK Prime Minister, contrived to take on members of his own party as well as the House of Commons and the European Union.

As can be seen from the graph, investor sentiment was more volatile during the quarter than might be deduced from simply comparing the start and end values for the period. Total returns from a rolling twelve month period look very appealing to a sterling investor, despite the poor experience of Q4 last year, with Government bonds producing more than 10%, Wall Street equities a similar amount and even the UK stock market generating a return ahead of domestic inflation. In the latest quarter the only segment of a broad portfolio not to contribute to investors' pockets was emerging markets, which remained under pressure from concerns about tariffs and free trade. All other asset classes registered gains and those that were denominated in currencies other than the pound also benefitted from sterling weakness.

Total Returns to a Sterling Investor



Source: Refinitiv Datastream

Past performance should not be taken as an indication or guarantee of future performance

Bond Markets

As we observed in the Background section, the confluence of trade tension and deterioration in global growth prospects prompted adoption of supportive accommodation by Central Banks through easier monetary policy; this drove bond yields through the lows previously attained in 2016 and, in a number of countries, inverted curves, an outcome in which Governments could borrow funds more cheaply for ten years than for two.

Investors frequently interpret such a pattern as a signal of rising recession risk and in many instances as a harbinger of recession itself. This cautious tone was reinforced by the weakening of the Chinese currency the renminbi which reached multi-year lows at more than 7.1 versus the US dollar, suggesting that one of the largest contributors to global growth was in need of stimulus via a more competitive exchange rate.

During the quarter there were 29 separate interest rate reductions from central banks, a material acceleration from the seven recorded in the previous quarter and only one during the first three months of the year. The attenuated concerns over global free trade, given President Trump's escalating friction with China and his widening of tariffs to include a number of European goods, meant that Central Banks felt impelled to loosen policy. They felt able additionally to justify such actions because there remained scant evidence of any escalating upward pressure on inflation; though labour markets were tight in the US, Japan and the UK and wage growth had accelerated slightly ahead of consumer prices, this had not led to any second round effects. Indeed of 19 countries, representing the major economies of the advanced and developing world, monitored by the economics team at JPMorgan, not a single one is experiencing inflation above the target set for their Central Bank.

As the chart here shows, sovereign bonds across a broad range of countries and of many different maturities stood at negative redemption yields at the end of September: the record amount of $13.5trn of bonds offering investors negative yields, that we mentioned in our last Review, expanded by a further $3trn at one stage during the quarter. The returns provided to investors were substantial from such moves and remarkably out of kilter with the defined payoffs from bond investments; for example an investor purchasing a 10yr German bund a year ago knew they would receive 6.7% return in total over that entire forthcoming decade, whereas the movement in yields meant they received more than 12% in the first year alone, ensuring a loss of more than 5% of their capital if they continue to hold the investment for its remaining nine years of life. Clearly bond investors have two options from which to choose, namely to remain as investors until the final redemption or to sell to another purchaser in the meantime, who may have different objectives (such as a Central Bank) or indeed a flawed view of value. Many investors will find such circumstances perverse and yet the adherence to benchmarks and renewed purchases by Central Banks inhibit the selling that should logically ensue. Other sovereign and inflation-linked bonds exhibited similar patterns and corporate bonds also enjoyed good returns, though (and quite logically) less remunerative than at the sovereign level.

Capital returns to a sterling investor

	3mth% to 30/09/19	6mth% to 30/09/19	12mth% to 30/09/19	12mth% to 30/09/18	12mth% to 30/09/17	12mth% to 30/09/16	12mth% to 30/09/15
Gilts	5.4	6.2	10.4	-2.1	-6.3	9.3	4.8
FT All-Share	0.1	2.1	-1.6	1.9	7.8	12.6	-5.6
FTSE 100	-0.2	1.8	-1.4	1.9	6.9	13.8	-8.5
Europe ex UK	1.3	7.9	3.0	-1.1	19.1	17.0	-4.0
US	4.5	11.1	8.1	19.0	12.5	31.7	4.2
Japan	5.4	8.0	-2.8	10.6	10.3	29.3	4.3
Far East ex Japan	-3.3	3.0	4.5	3.2	6.6	34.4	-14.4
World	3.1	9.0	5.2	11.4	12.6	27.8	-1.6

Source: Datastream

Negative sovereign bond yields becoming commonplace

	2yr	5yr	10yr	30yr
Germany	-0.78	-0.77	-0.55	-0.04
France	-0.72	-0.64	-0.23	0.56
Netherlands	-0.78	-0.71	-0.43	-0.08
Spain	-0.52	-0.31	0.15	1.05
Italy	-0.28	0.22	0.85	1.94
Ireland	-0.58	-0.48	-0.04	1.53
Sweden	-0.65	-0.65	-0.29	
Switzerland	-0.97	-0.94	-0.81	-0.39
UK	0.33	0.25	0.46	0.95
US	1.54	1.49	1.64	2.10
Canada	1.57	1.39	1.35	1.52
Japan	-0.31	-0.32	-0.15	0.39
China	2.63	2.90	3.10	3.68
Australia	0.63	0.67	0.97	1.55

Source: Bloomberg September 2019

United Kingdom

The mood in the UK can best be described as febrile and that is a label that can be applied equally to both politicians and investors. Boris Johnson won the leadership contest for the Conservative Party in late July and duly became Prime Minister.

His term of office did not start propitiously however, losing all six of his first Parliamentary motions as he endeavoured to muster support for an early General Election. Subsequently his Government triggered a prorogation of Parliament, though a legal challenge led to the Supreme Court ruling such a suspension to be unlawful. The Prime Minister's approach to delivering Brexit has been characterised as "do or die", exemplified by his own comment that he "would rather be dead in a ditch than ask for a delay". Rising tensions led 21 Tory MPs to vote with the Opposition and they were summarily ejected from the Party. The atmosphere in the House of Commons has become highly charged with many of the debates featuring extremely unseemly behaviour as we approach the existing deadline of October 31st with no sign of an agreement either within Parliament or between the UK and the European Union on revised exit terms. Although the likelihood of a no-deal Brexit has probably reduced following the passing of the Benn Act, which requires the PM to seek a three month extension to the Brexit deadline in the event that Parliament does not ratify an exit deal by October 19th, sterling continues to be buffeted by every piece of political newsflow.

After the robust performance of the economy during the first quarter of the year, the inevitable correction occurred and GDP was reported as negative for Q2 as stockbuilding was reversed and industrial confidence subsided further while awaiting certainty on the Brexit outcome. With export volumes failing to benefit from a more competitive sterling exchange rate, it was left to consumer spending to shore up economic activity; higher real wages, as annual increases overtook inflation for the first time in several years, and the ongoing payouts from mis-sold Payment Protection Insurance claims, limited the decline in the economy. Furthermore the number of people in employment continued to rise as more than 350,000 individuals joined the workforce during the latest twelve months. About a third of this addition registered themselves as self-employed but the majority of the increase reflected businesses preferring to add to headcount than o sanction capital spending plans ahead of any Brexit decision.

With the economy likely becalmed until Brexit is resolved and the Bank of England in no position to act on interest rates, most investors' attention has fallen on sterling. It is well understood that more than two-thirds of the revenue earned by the companies making up the UK stock market stem from overseas economies through both exports by domestic businesses and from overseas operations of UK companies. This has made the UK stock market an inverse barometer of Brexit expectations, so that an increased possibility of a no-deal outcome would weaken sterling but the lower exchange rate would add to UK corporate profits calculated in pounds, thereby supporting share prices. One aspect of this relationship which is not well appreciated however is that most economists use the Bank of England's trade-weighted calculation to measure the strength or weakness of the pound; this reflects that more than twice as much trade is done by the UK with Europe than with the US. The strategy team at Citigroup have modified this calculation to base it on the currency mix of revenues for the constituents of the FTSE index, which have a much greater preponderance of dollar trade. The chart here illustrates that the prevailing level of the UK stock market fails to reflect all the weakness in the pound when recalculated on this basis (due to the dollar being much stronger than the euro) and may reflect investors choosing to avoid the UK market irrespective of valuation until the Brexit clouds clear.

Some corporate investors have alighted on this anomaly as reflecting an opportunity for acquisitions and during the past quarter bids were launched from overseas for the defence contractor Cobham, the leisure company Greene King and the London Stock Exchange itself. Overall returns from UK shares during the three months were just above 1%, though share prices of smaller companies in aggregate fell due to their greater reliance on the domestic economy. At a sector level, the highlights were shares in healthcare and telecoms, whilst the weakest performers were found in the most cyclical areas such as oils, mining and chemicals. Profit estimates for the UK market, whilst lower than made back in the spring, still reflect a modicum of growth and this should permit a modest increase in dividend payments, sufficient to offset inflation for investors.

UK Blue Chips – under-recognised play on a weak pound

Source: DataStream, Citi Research

United States

Investors in Wall Street are torn between their appreciation of the continuing growth of the US economy and the political clouds surrounding Mr Trump. Much has been made of the fact that this economic cycle is now the longest on record, surpassing the previous stretch between 1991 and 2001; the new high was set when data for Q2 revealed another positive outcome for growth though at a materially slower pace than in the first quarter of the year.

While the persistence of this growth has helped to underpin the current bull market for equities, the gradient of this recovery is one of the shallowest on record, certainly in the post-war era. The current expansion phase, which now stands at 45 quarters, has produced annual growth of a mere 2%, whereas previous cycles have frequently reflected 4% or more and the past ten have averaged well above 3%. One factor behind this more sluggish rate of progress is that the household sector has been steadily reducing its level of debt.

As the chart here illustrates, household borrowing as a percentage of national income rose steeply during the 15yrs that preceded the financial crisis from 60% to 97% and, in the fifty or so years prior to 2010, barely ever registered a decline. However since this present economic recovery began, consumers have worked hard to repair their individual balance sheets, taking this measure back down to below 75%. Their increased savings and lower readiness to utilise credit facilities have been two of the principal factors behind the lacklustre pace of growth in the current economic cycle and consensus forecasts for the next few quarters are for the growth rate to slow even further.

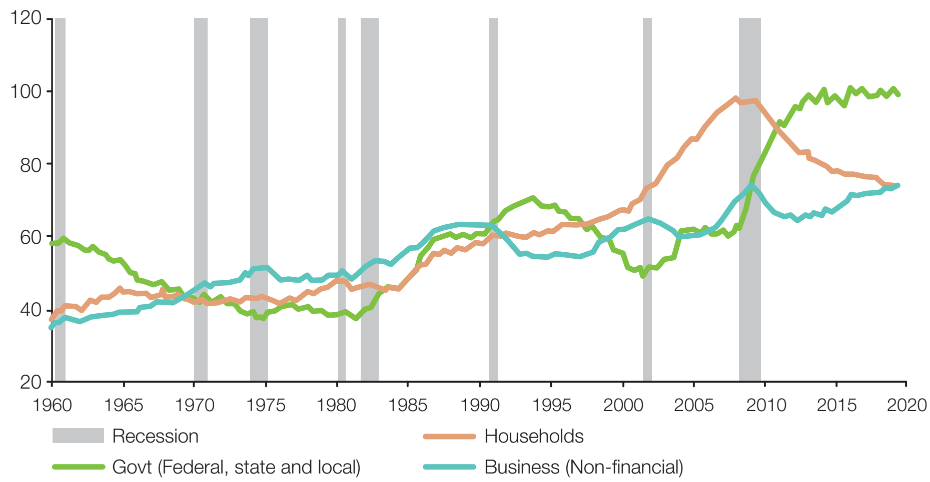
Encouragingly for both economic growth prospects and consumer confidence levels, unemployment has persisted at almost 50yr lows and the fall in US Treasury yields mentioned earlier has lowered the cost of mortgages. This combination should prompt a rebound in the housing market and new building permits have more than recovered the dip in activity which occurred last year.

Mr Trump's increased use and amount of tariffs is boosting the level of inflation in the near term: core inflation (which excludes the impact of both energy and food prices) is running slightly above the target of the Federal Reserve (Fed). Nevertheless the deflator measure used by the Fed as its preferred indicator remains comfortably below the 2% level and this has allowed Mr Powell as Fed Chairman to unveil its second interest rate reduction. Part of the Fed's justification will also be the level of international tension around tariffs and global free trade and it will be keen to offset, if it can, any increase in economic uncertainty that stems from presidential actions. However the members of the Fed Committee appear to be very divided on the future path of interest rates over the next year, as demonstrated by the release of the "dot plots" data – these reflect the views of the 17 individual members and show that eight members predict lower rates in a year's time but seven others forecast rates to be higher.

The President in recent weeks has expanded the level of tariffs with increased amounts levied on a wide range of Chinese goods while also including a number of European items in his basket and even targeting India in his rhetoric over their existing levels of tariffs imposed on imports. While that will have raised tempers across international boundaries, Washington too has experienced inflamed emotions as the Democrats sought to begin the process of impeachment as it became apparent to them that the President had reportedly threatened to withhold US aid from Ukraine if they didn't launch an investigation into the affairs of the Biden family (Joe Biden being a front runner to be the Democratic nomination for next year's Presidential Election).

Wall Street has continued to be the beacon for global equities and notched up another positive quarter, though of lesser scale than either of the preceding quarterly periods. Gains emerged at less than 2%, but were still achieved against a backdrop of falling analyst estimates for corporate profits in 2019. From the rosy height of 9-10% growth that reflected consensus estimates back at the start of this calendar year, the current expectation is for around 2-3%. That 7% reduction in profit forecasts should be seen in the context of a gain of almost 20% in US share prices in the same period, leaving the index on a relatively demanding rating of close to 19X expected net profits. The principal factor restraining investors from reducing exposure to such an expensive market is the shortage of growth opportunities elsewhere and the prevalence of many US quality multinationals in the universe of growing companies, most obviously in the technology sector.

US debt as % of GDP



Source: Refinitiv Datastream, Schroders Economics Group. 24 September 2019

Past performance should not be taken as an indication or guarantee of future performance

Europe

Following a strong first quarter of the year for economic activity, the pace lessened in Q2, with growth recorded of only 0.2%. This was broadly in line with expectations as weakness in Germany dragged down the Eurozone as a whole.

The Iberian peninsula countries of Spain and Portugal, together with the Netherlands, led the way with growth of 0.5%, but France, Italy and Austria all performed less strongly than in the first quarter while Germany was actually in negative territory. The principal explanatory factor behind this outcome was the weakness of global trade, where Germany has a heavy reliance on exports, but its cause was not helped by ongoing difficulties in the car industry following the emissions scandal and by lingering concerns about the navigability of the River Rhine, a main trade route for German goods. The September reading of the German Manufacturing Purchasing Managers Index (PMI) sank below 42 (with a value of 50 indicating unchanged conditions) and pointed to the steepest decline in output for a decade. By contrast French PMI data showed an outcome of 50.1, though Italy and Spain both reported outcomes lower than in August and below the 50 level.

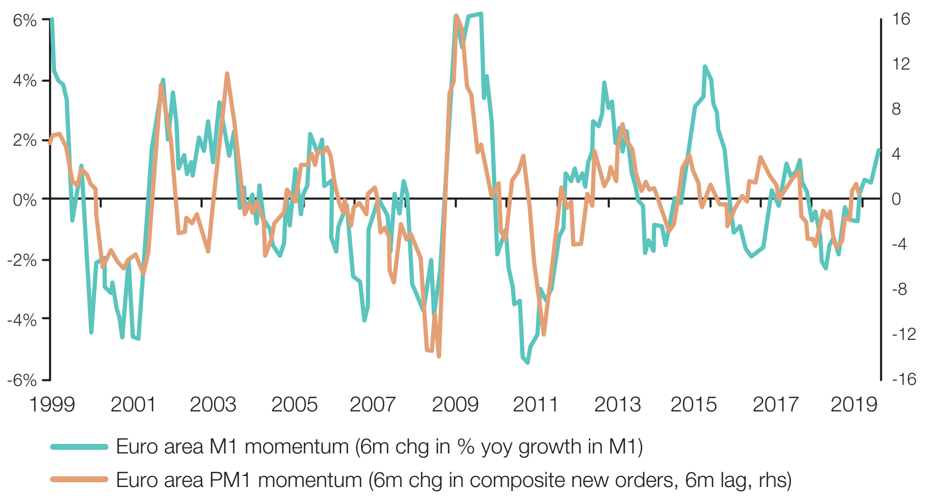
Unemployment across the Continent has continued to decline, with the rate for August reaching 7.4%, only a fraction above the low point of the past twenty years and materially lower than the peak of 12% recorded during the winter of 2012/13. The range of principal countries extends from Germany at the low point of 3.1% (unchanged over the last three months despite the economy retreating), to Spain at the high point of 13.8% (continuing to fall on a monthly basis), with France also unchanged over the past quarter at 8.5% and Italy at 9.5% also continuing to drop. This positive backdrop is supportive of consumer confidence, which has proved to be much more resilient than business equivalents in the past few months, and should enable spending to remain on its current modest uptrend.

The escalating level of friction in international trade will undoubtedly hit the Continent hard and fears of that were behind an easing of interest rate policy by the European Central Bank (ECB) at its September meeting. Undoubtedly the amount of uncertainty over the direction of Brexit will not have helped anyone on the Continent with export markets in the UK. Mr Draghi as head of the ECB unveiled a cut of 0.1% in its deposit rate, taking it to -0.5%. He is soon to hand over the reins of the Central Bank to Christine Lagarde, formerly at the International Monetary Fund (IMF). She will assume office with effect from the beginning of November, having spent about eight years as Managing Director at the IMF. Mr Draghi will chair one further meeting of the ECB Council in late October. In addition to the lowered policy rate, the ECB decided to resume its programme of quantitative easing (QE), by committing monthly amounts of €20bn with effect from the beginning of November. Given the previous phase of QE included an effective ceiling of purchasing no more than one-third of any member Government's bonds, it is easy to see why markets concluded that renewed demand for bonds from the ECB and limited supply (in light of the narrowing fiscal deficits) might lead to even more negative yields.

Some encouragement amongst the gloom is offered by the chart here, which illustrates that money supply in Europe has resumed its uptrend after the dip in Q2 and has now surpassed the peak of spring 2018. Should international tensions dissipate and domestic demand continue to be solid, then the current bleak path for PMIs could reverse. In that regard European equities, rather like the UK but for entirely different reasons, have been neglected by global investors and look cheaply rated. Though analysts have reduced profit forecasts for Continental equities as the months have passed since the spring, their expectation is still for 4% growth in calendar 2019 and 8% next year. The dividend yield of c3.5% is very appealing compared with the potential returns from bonds. In the latest quarter, shares recorded very modest gains, with Italy and France in the vanguard.

> “Undoubtedly the amount of uncertainty over the direction of Brexit will not have helped anyone on the Continent with export markets in the UK.”

Money Supply indicates PMI should bounce in the next few months



Source: BofA Merrill Lynch Global Research, Haver

Far East & Emerging Markets

It would be difficult to begin any coverage of this area of the world without mentioning the phrase "tariff war". All eyes have been on the rhetoric used by President Trump, the type and scale of response from the authorities in Beijing and the movement of the Chinese exchange rate.

Starting with the latter, some weakness in the renminbi is a perfectly rational market response to trade frictions and the breaching of the 7.0 level versus the US dollar prompted a furious reaction in Washington labelling China a currency manipulator. The Central Bank in Beijing has however for several years endeavoured to manage its exchange rate around a trade-weighted index value, which can differ markedly from the rate against the dollar. Since China moved away from the formal dollar peg in 2015, the greenback has been one of the world's strongest currencies, so some weakening against it is quite understandable. In an ironic way, Mr Powell's actions at the Fed in lifting US rates throughout 2017 and 2018 triggered much of that dollar strength so his recent change of path will be coming to Beijing's assistance.

China's economy continues to cool, with August's industrial production rising by a mere 4.4% annualised, well below economists' forecasts, and representing the weakest yearly growth for more than 15yrs. Retail sales grew at 7.5% in August, more closely in line with expectations, but still the second slowest annual rate since the financial crisis. The response by the authorities to this recent cooling has been to make a number of reductions to the Reserve Requirement Ratio but they are also mindful of the problems in the shadow banking system from earlier years, hence their stimulus being regarded as tepid in some quarters.

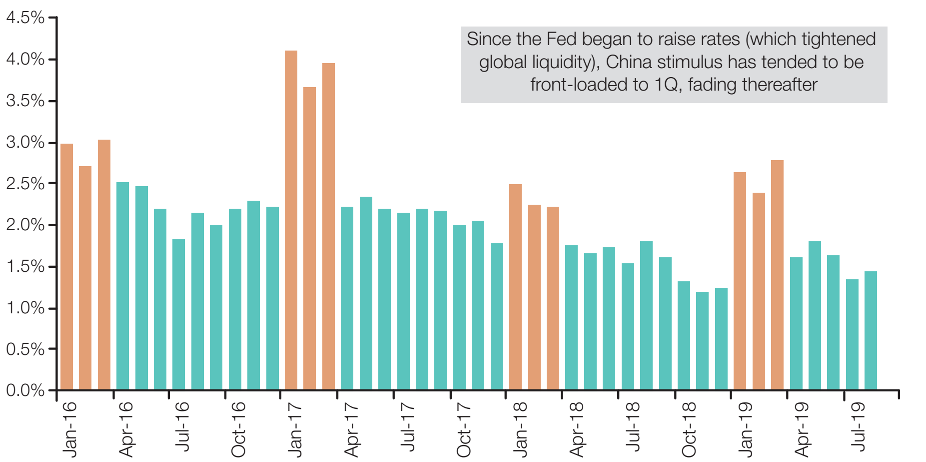
The chart here indicates a distinct seasonal pattern to the injections of stimulus by the Chinese authorities and suggests they might be in no hurry to accelerate support for the economy in the remaining part of this year. Uncertainty about the likely course (and timing) of action is magnified by the current political disturbances in Hong Kong and by the on/off conversations between Beijing and Washington (which are expected to resume in October). Clearly China will be well aware of the timing of US elections and may conclude that time is on their side from the perspective of seeing "who blinks first" in their desire to reach an accord. Nevertheless recent official comments do indicate that more policy stimulus is coming.

India surprised markets during the quarter by cutting its effective corporation tax rate from 35% to around 25%. This measure has come on top of cuts by the Central Bank in domestic interest rates, justified by both lower inflation (the annual rate of core CPI is almost 2% lower than it was a year ago) and by the weakening sense of momentum within the economy. For most of the past five years, Indian GDP has grown consistently in a range of 6% to 9%, but the recent announcement that growth in the second quarter sank to a low of 5%, missing consensus forecasts of 5.7% by a very wide margin. While cuts in the cost of money will be welcome, the speed of response in the economy to such stimulus is not rapid, as we highlighted earlier in this Review. Capital spending is both a long term necessity for the unlocking of the country's potential but also more likely to be implemented in the short term because of the tax reduction.

Overall emerging market equities struggled against the twin headwinds of trade uncertainties and slowing global growth momentum and the resilience of the dollar made it additionally difficult for investors to forsake that currency exposure for higher risk ones. Investor confidence was also not aided by the events in Argentina, where the dollar equivalent of its stock market index dropped 48% during the quarter, though that country forms but a small part of the global emerging index benchmark.

"Clearly China will be well aware of the timing of US elections and may conclude that time is on their side from the perspective of seeing "who blinks first" in their desire to reach an accord."

Chinese stimulus as % of China's nominal GDP



Source: Stifel September 2019

Past performance should not be taken as an indication or guarantee of future performance

Japan

Japan has proved comparatively resilient to the colder winds of change blowing around the world in recent months, as economic growth has more than matched low expectations during the first half of the year and any downward revisions to GDP growth forecasts have been limited to minor adjustments and almost exclusively in 2020.

Recent data from Q2 indicated that domestic demand more than offset any damage to export activity triggered by the global trade frictions and both consumer demand (in anticipation of the autumnal 2% rise in VAT rates) and business capital spending (potentially augmented by planning for the Rugby World Cup and next year's Olympic Games) recorded improvements above consensus forecasts. This enabled GDP to surprise on the upside and gave the authorities sufficient confidence to push ahead with the proposed rise in VAT, which had been postponed twice in recent years.

The authorities continue to adopt a loose monetary position and bond yields remained in negative territory with the 10yr yield ending September at a level of -0.23%. Corporate profits reflect the ongoing programme of business reform and shareholder friendly governance changes and these have helped to push consensus forecasts for growth in the next fiscal year above 5%. Dividends are also on an upward path and yields on the broad equity market index are now approaching a level which is c3% higher than that on their Government bonds. Such a premium has served to make Japan one of the best performers among stock markets during the past quarter, more so for international investors given the strength of the yen, and the low rating and prospects for further increases in profits and dividends should keep the equity market well supported.

> "Corporate profits reflect the ongoing programme of business reform and shareholder friendly governance changes and these have helped to push consensus forecasts for growth in the next fiscal year above 5%."

Alternative Assets

Heightened levels of investor uncertainty about the global economy, together with strong demand for income producing assets, has kept infrastructure in the vanguard of popularity in recent months.

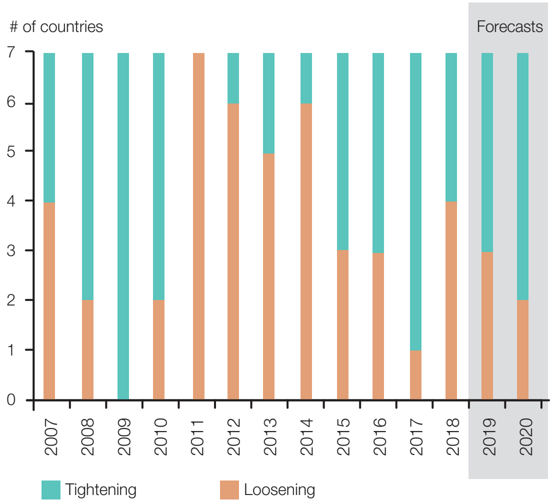
Both segments of the asset class, namely social (such as schools, hospitals, transportation and utility services) and renewable (solar and wind generation) projects typically have operating contracts that range from 15 to as much as 30 or more years and have high levels of inflation linkage in their future revenue streams. The stable nature of these income flows, which in general, are relatively insensitive to fluctuations in economic activity has proved highly attractive to investors and the only real exception to this appetite occurred in the wake of Labour's threats of nationalisation at their Autumn 2017 party conference, which prompted some temporary weakness in several share prices. However the poor showing of Labour in the opinion polls in recent months has meant that such a prospect has receded from investors' minds and share prices have made gains on a broad front.

During the year to date, Governments in many countries have either increased spending on infrastructure projects or pledged to do so and the funds have been able both to attract more investor capital and deploy it rapidly into either operational or development assets. This enhanced scale has driven another benefit in the sense that the increased size of these funds and the concomitant improvement in the liquidity of their shares has enabled a number of large pension funds and insurance companies, who are attracted by the characteristics of the asset class but do not have the internal management capability to acquire the projects directly, to become significant shareholders. Despite strong price performance, most of these funds can still offer long term indicative returns of over 6% net of their fees which is appealing compared with the likely future returns from both sovereign and corporate bonds.

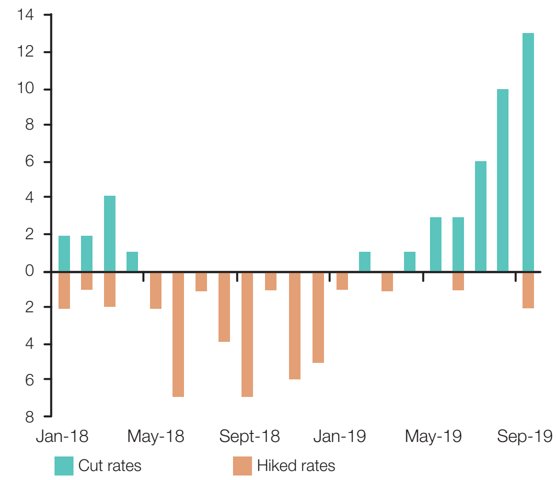
Outlook

Could 2020 bring both Fiscal and Monetary Policy easing?

Change in the fiscal stance in G7 countries



Number of central banks:



Source: Barclays September 2019

The diminishing momentum in the rate of global economic growth has been the main point of discussion for strategists pondering the most appropriate balance of portfolios in recent months. In line with the majority of similar circumstances since the ending of the financial crisis, the Central Banks rode to the rescue by cutting interest rates and, in the case of the ECB, resumed its QE programme. The US Fed has now gone five years since its last purchase via QE and has stopped short of any specific reference to resuming it, though mention has been made of the potential to "accelerate the timetable towards balance sheet expansion". As many observers have noted, endeavouring to create additional demand solely by cutting interest rates has been likened to pushing on a piece of string. Thus, while sovereign bonds are not a source of risk in terms of likely default, they are increasingly not a source of longer-term return as yields have sunk to microscopic levels; they will however potentially still perform less badly than equity markets in the event that global economic growth forecasts prove still to be optimistic or because Central Banks re-enter bond markets with even larger cheque-books to stave off a return to recession.

A different source of stimulus to the global economy could come from politicians who might be able (or be persuaded by weakening domestic growth prospects or rising levels of populism) to loosen the purse strings of fiscal policy. This is already visible in the tactics of President Trump and became apparent in the recent comments from the UK Chancellor of the Exchequer Sajid Javid in which he referred to "turning the page on austerity". The chart here indicates that there is a definite loosening of fiscal policy across the G7, with five of the seven expected to enact a less austere tilt to policy next year. Not only would that create either additional government spending, or tax cuts that might then be spent, but governments could reassure themselves that the cost of additional sovereign issuance would be negligible, given prevailing levels of bond yields. Any such increase in supply, relative to present expectations, should be negative for the prices in bond markets, whilst providing reassurance to investors in risk assets that the dismal prospect of even lower global growth had been reduced.

Ordinarily a rational investor would therefore be reducing exposure to bonds to redeploy into risk assets, to benefit from such an outcome. Timing such a switch however involves believing that politicians will grasp the nettle with sufficient enthusiasm that the path of economic growth is distinctly affected. Just as negative interest rates were not covered in economic textbooks and Central Banks becoming the dominant owner of their own countries' bonds would have been deemed a work of fiction by most economists of the past half-century, so investors today are struggling to find the optimal balance between risk and reward in unprecedented circumstances. Adding to risk assets feels potentially the correct tactic, but perhaps more obvious is to reduce exposure to bonds and endeavour to find more rewarding, but still largely economically insensitive, assets. Such thinking explains the recent popularity of both gold and infrastructure assets, as well as that of real estate with longer-dated leases.

Bath	01225 341 580	**Edinburgh**	0131 226 5000	**Liverpool**	0151 227 2030
Belfast	02890 321002	**Exeter**	01392 204404	**London**	020 7597 1234
Birmingham	0121 232 0700	**Glasgow**	0141 333 9323	**Manchester**	0161 832 6868
Bournemouth	01202 208100	**Guildford**	01483 304707	**Reigate**	01737 224223
Cheltenham	01242 514756	**Leeds**	0113 245 4488	**Sheffield**	0114 275 5100

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Out of the Ordinary

IWI069 10/19