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Much Heat – Little Light?

Last week on my travels around the country I met both Remainers and Leavers who are firmly entrenched in their views. But I also met Remain voters who now want to leave and Leavers who, having re-evaluated the evidence, want to remain. And there were also plenty who were just plain fed up with the whole thing. Maybe it's no surprise, then, that, after what was supposed to be a defining weekend, we are no further forward than we were on Friday. All the outcomes including a Deal, "No Deal", Article 50 extension, general election and second referendum are still on the table. Perhaps the only meaningful shift is that the probability of a "No Deal" exit has fallen further, and (as discussed last week) that has been reflected in the pound's continued appreciation and higher government bond yields.

I always appreciate a witty neologism - "Neverendum" is my favourite – and I note a new book by former Labour MP Denis MacShane entitled Brexiternity, which captures the feeling well. Remember that what is currently under discussion is not in fact a "Deal" as such, but a "Withdrawal Agreement". The nature of our trading relationship with the EU will be thrashed out later, and that itself is likely to be highly contentious. More positively, though, as Churchill once said of something much more serious, perhaps this could turn out to be the "end of the beginning". This optimism stems both from the fact that a new Withdrawal Agreement has been crafted, and also from more coherent party-political positioning. On the former point, it is possible that the new proposed agreement will be passed during the next two weeks. For the first time it appears to have the backing of nearly all Conservative MPs and could also attract enough support from opposition MPs whose constituencies have been amongst the most ardent supporters of Brexit. On the latter, if the deal is not passed in parliament - assuming an extension is granted by the European Council - the newly clear party-line divisions in relation to Brexit policy suggest a general election would now settle the matter. Why do we think this? If either the Conservatives or Liberals were to win an outright majority, they would respectively be likely either to re-present the current deal or to cancel Brexit, both being definitive outcomes. If Labour were to form a government, their promise of another referendum on Brexit would see a delayed and finely poised outcome, but a finally decisive ending nonetheless. In short, by the end of 2019 there is an increasingly high likelihood both that the UK will have a clearer path in relation to the European Union and also that the path will be less hard than many have feared.

This week I am off to Belfast, and it was there in early 2018 that the sticking point of the Irish border was first highlighted to me, long before it had become the main bone of contention in the negotiations. I'll be interested to see what the mood is like now. Casting the net further afield, last week felt very much like a "limbo" week generally, allowing most equity markets to creep ahead in local currency terms, even if not when measured in sterling. There was no more progress on the trade negotiations between the US and China, despite a series of anodyne statements about "substantial progress" and "important foundations". This week might see a few more fireworks because Vice President Mike Pence is scheduled to make a policy speech on China on Thursday, and he is a recognised "China hawk". We note that his last outing on the same subject in early October 2018 was one of factors that contributed to the fourth-quarter equity market sell-off last year. Will it be another case of the "good cop, bad cop" strategy, which has characterised the negotiations?

Another echo of October 2018 came in the International Monetary Fund's latest downgrade to its global economic growth forecast for 2019 last week. It cut the expected rate of growth from 3.3% (as of April) to 3.0%. That's against the 3.6% achieved in 2018, and so a meaningful slowdown. The IMF still expects a rebound to 3.4% in 2020, but that assumes no significant escalation of the US/China trade war. It also notes the dwindling supply of monetary ammunition available to central banks in future. The "stall speed" for global economic growth at which global corporate earnings growth declines to zero is calculated to be around 2.8%, and so at least we are still just on the right side of that line. Remember, though, that a year ago the consensus forecast for earnings growth this year was around 10% versus 1 or 2% now. It was the beginning of that downgrade process that was another of the catalysts for the market falls. We are now entering the peak of the current third quarter reporting season, and so far, at least, the results have been a touch better than expected.

The hat-trick of negative catalysts a year ago was delivered by tightening monetary policy and liquidity conditions, and we have been at pains to point out that this remains the single largest difference currently. Central banks are now generally in easing mode, and the aggregate global central bank balance sheet is growing again. Even so, this is no panacea. The fact that extraordinarily easy monetary policy has delivered relatively meagre economic growth relative to history points towards more structural underlying constraints as well as the negative unintended consequences of zero or negative interest rates. Bearing that in mind, we continue to believe that looser fiscal policy will constitute the next shot from the policymakers' bazooka, and that is already being reflected in political manifestos and voting intentions. Whether this policy shift will have its own unintended consequences (such as markedly higher inflation, for example) and what effect that will have on asset allocation (maybe a shift in favour of the Value style) remains to be seen, but we will keep a close eye on it.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Royal Bank of Scotland Group	9.2%
Marks and Spencer Group	7.9%
Land Securities	7.3%
British Land Group	6.5%
ITV	6.3%
Legal & General	5.6%
Persimmon	4.9%

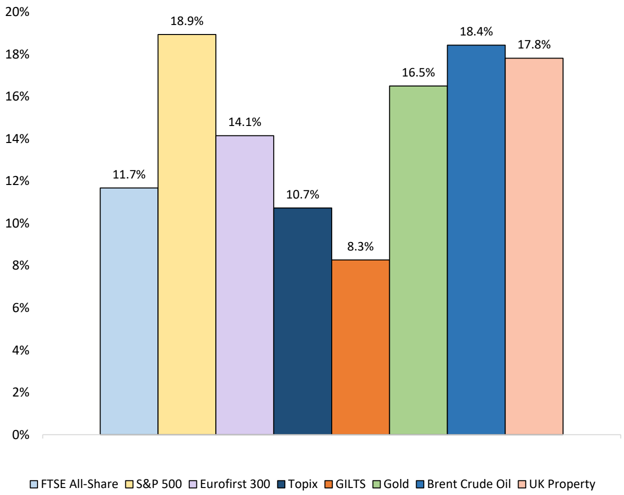
Source:FactSet

FTSE 100 Weekly Losers

Evraz	-13.6%
BHP	-7.0%
Burberry Group	-6.4%
Hargreaves Lansdown	-6.0%
Intertek Group	-6.0%
Rio Tinto	-5.9%
Coca-Cola	-5.4%

Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months

Source: FactSet