Psigma
Investment Management

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Brief View from Psigma

"SUMMER SQUALLS"

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Having spent last week in France with three small children, it became increasingly apparent how meticulous one must be about planning the day around the unpredictable summer weather. Too much sun, the children get irritated. Too much rain, the children get irritated. Insufficient wine consumption, their mother gets irritated. Most of the time, I get irritated. Much as with a very pleasant séjour in the Charente-Maritime, markets have had their fair share of burning sunshine and sudden summer squalls over recent months, meaning that investors have been able to feel burnt to a crisp and rain-drenched almost at the same time.

As is quite often the case in the "quiet summer months", where liquidity is reduced and market moves pronounced, markets have become "unpredictable" for very understandable reasons, which we will discuss here today.

2019 has been a remarkable year in that fundamental assessments of the global economic environment and corporate profits have become (for the most part) pointless. Equity markets have become far more akin to a roulette wheel where investors are betting on central bank policy and political matters rather than assessing how well things are going for that investment. That equity markets have soared higher and higher in the face of a global economy that is slumping to its weakest state since 2009 and corporate profitability growth has basically dried up, is a reflection that all investors really care about is the expectation of central bankers riding to their rescue and pumping cheap money into the financial system. It also shows that there is a broad belief that the growing frictions around the world over trade will blow over as quickly as a summer storm.

Let's start with the actions of central bankers and an upfront admission that it would be totally naïve to pretend that the central banking playbook used since 2009 has been anything other than hugely powerful for asset markets, even if we must recognise that most actions have been pointless and destabilising from an economic perspective. We have seen that the modus operandi of most major central banks will be to loosen monetary policy further in the coming months, thereby both reducing the cost of debt and supposedly increasing the flow of debt, in an attempt to boost economic growth. In our view they should know by now that the economic efficacy of such policies is limited, but it could well be that they stabilise markets in the short term and allow markets to make further gains. Ultimately, we believe that central bankers should stand pat, that they should try to encourage some normalisation in the financial system and stop feeding more cheap debt heroin to the "hooked" global economy. Clearly though that is not going to happen. That their actions have now led to nearly a quarter of all outstanding global bonds having a negative yield (some $15trn worth) is leading to desperate capital allocation decisions as income-strapped investors are forced to take more risk. This effect is most obvious in the stretched valuations seen in many corporate fixed interest and equity markets around the world; but as Keynes once remarked "the market can remain irrational longer than you can remain solvent" and betting on a change in this might be the wrong decision.

We must also continue to discuss both the domestic and international political situations. In the UK, it has become obvious both in the refreshed government's message and the financial markets that a chance of "no deal" divorce between the UK and Europe has risen to a "coin toss" situation. There will be a lot of volatility in the next few months, but we believe we are getting to the point where the "worst-case" scenario is priced in to UK markets and we are reviewing any positions in UK gilts and seeking to add more sterling exposure. Selected UK assets look like an interesting contrarian opportunity to us.

Much more important than the never-ending story that is "Brexit" is the growing spat between the US and China, which has morphed from a trade conflict into a major debate over national security. Our view remains that ultimately a flimsy and pointless deal will be reached over trade, allowing both sides to claim victory, but that Pandora's Box has been opened and a new "Cold War" has been let out between the world's two biggest economies. This will continue to create moments of drama for markets in the coming years and could well act as a brake on the global economy should the situation continue to deteriorate.

The fact that all these discussed issues are culminating at the same time should undoubtedly be a worry for investors with valuations across markets high and examples of complacency everywhere. If markets do not correct at this juncture or at least cool down after a meteoric rise from the start of the year, it will be telling you that the central bankers are blowing a big bubble in markets. We would advise investors to tread with care and ensure that one's investment portfolios has an adequate mix of investments to make hay while the sun is shining and those that can protect when the heavens open.

What does that mean in terms of our clients' portfolios? Our portfolios have gradually been de-risked from the start of the year, with profits taken in investments that have done well and cash levels gradually building. We are actively seeking places to deploy cash and re-examining the laggards in global asset markets, such as Japanese equities. We have taken profits from global equities, UK equities, infrastructure equities and gold mining companies, all of which have been key beneficiaries of the market environment from the start of this year. On balance we remain highly diversified, with an appropriate balance across investment themes and have maintained a strict focus upon liquid investments. More importantly, we continue to be very active with our investment portfolios and stand ready to change tack should the market environment change, as seems highly likely in the coming months.

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