



THE POWER OF THE CYCLE

QUARTERLY ECONOMIC OUTLOOK Q1 2020

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Foreword

Following a flat third quarter, global equities rallied to the end of the year with the MSCI World index up over 7% in local currency terms. Returns for unhedged Sterling based investors were broadly flat as the Pound strengthened following the Conservative's decisive general election victory. The late final rally was primarily driven by renewed optimism for a 'phase one' trade deal between the US and China, and left global equities up 25% for the year. It is of course important to note that, by contrast, markets ended 2018 in very pessimistic mood as the Fed continued to raise interest rates, and therefore a global equity return figure of around 8% from September 2018 is a more useful measure of equity returns.

Trade deals (or not) aside, it is indisputable that the real driver for these spectacular returns was the Fed's complete U-turn on interest rate policy. Despite strong labour markets and moderate economic growth, and with a prevailing concern that there was little monetary policy ammunition available to deal with the next recession, the Fed reversed its stance of raising interest rates, citing (valid) concerns about global growth and trade. The continued absence of any meaningful inflation was also a factor. This turnaround, together with the continued loose monetary policy still adopted by the world's other major central banks set the environment for equity price inflation as yields on 'safer' asset classes once again became unattractive.

Thus 2019 ended with equities looking 'expensive' once more. Economic fundamentals played no part in this stock market reflation, as what growth we saw was paltry at best, and leading indicators of future economic activity gave no reason for optimism. Investors once more find themselves forced into buying equities despite a lack of corporate profit growth. Some days this feels uncomfortable, but thanks to the stance of central banks this discomfort can be easy to ignore.

And so to Brexit. Whatever one's view of the merits or otherwise of leaving the EU, it is difficult to argue with the notion that the malaise which Parliament has been in over the last three years has not been helpful for the UK economy.

Boris Johnson's strong majority does now give the UK some clarity about the direction of travel and goes some way to removing the oft mentioned 'uncertainty' which has been purportedly affecting investment decisions. What does remain unclear is what sort of Brexit we will end up with. Some commentators had posited that a large majority might mean the possibility of a softer Brexit, but Johnson's decision to put a hard deadline on the date of leaving might indicate otherwise. Much has been made of the normal timescales for a trade negotiation, but what is at stake, and indeed the starting position, mean that this negotiation is far from normal.

Although uncertainty remains over the direction of Brexit, our Investment Committee decided that the definitive outcome of the election is likely to spur greater investment, making UK equities a more attractive proposition at current valuations. As such we have initiated a position in UK small-cap equities, moving marginally overweight equities as a whole, reducing cash and gold where we have been overweight. The decision was also taken to switch from index-linked gilts, which have performed extremely strongly in recent years, and instead purchase conventional gilts.



DAVID BAKER

Chief Investment Officer
Mazars Wealth Management



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2020: The Power of the Cycle

John Kenneth Galbraith, an irreverent but brilliant economist best known for his work on the Great Crash of 1929, famously lamented about his own profession: “the only function of economic forecasting is to make astrology look respectable”. As always, we toyed with the idea that the first issue of the year would be an outlook of things to come. Nothing turns a page like a heading with “What 2020 brings”, be it in sports, finance or even gossip. And while we all know that by March these outlooks are hardly worth the paper they are printed on, they are still good fun.

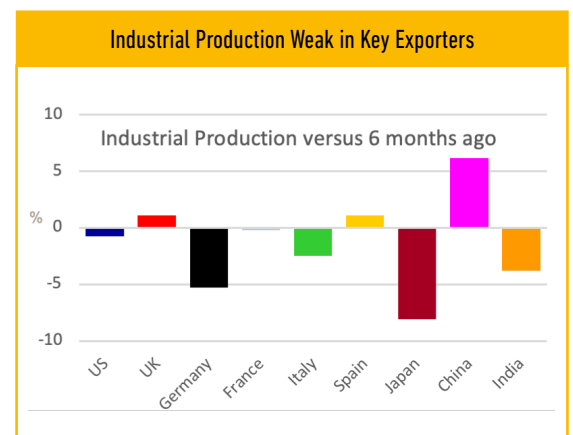
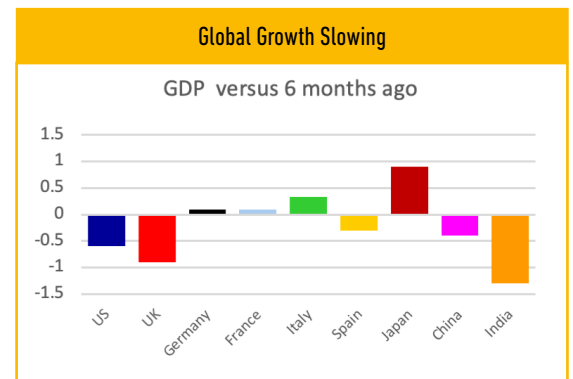
However, expectations for entertainment may be more readily fulfilled by watching the next instalment of “The Crown”, Christmas football, or even participating in mind-numbingly silly pub quizzes. By comparison, reading a quarterly from one’s financial planner is a bit of a distance from the dictionary definition of “fun”.

Our clients expect from us serious answers about financially thriving in a world where growth is slow, markets are anything but efficient and resentment about all this rampant.

Having said that, global bond and equity markets are ending the year near all-time high levels, prompted by even more central bank printing, so the question is “how serious are the risks that this will change going forward?”. Our first quarterly of the year will, thus, be to sanguinely tackle our own “Wall of Worry”: An analysis of issues that should worry investors going forward and, more importantly, highlighting those issues which tend to create too much anxiety relative to their probability that they will be important for one’s economic future.

Cheap money versus fundamentals

Normally, a lookback into the previous year offers little, especially given the tendencies of the industry to over-analyse the present and then draw a straight line into the future. But 2019 reminded of some key lessons.



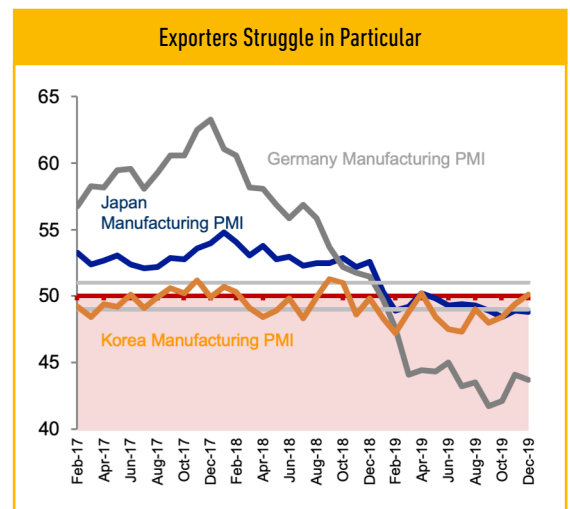
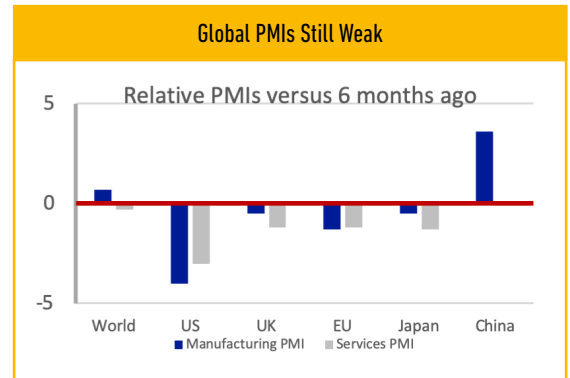
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2020: The Power of the Cycle (continued)

The year was marked by a stark divergence between a deteriorating macro and microeconomic, and – what is worse – policy backdrop (economic numbers speak of the past, policy is key to determining the future) and soaring risk asset prices, for both bonds and equities. The beginning of 2019 looked ominous, with equity markets near 20% down. Throughout the year, the backdrop for key fundamental indicators, such as aggregate growth, corporate earnings, consumption, manufacturing and services was dismal. China was evidently slowing, affecting the world’s major exporters, Germany, Japan and even the US. The American economy held better, but as the effects of Mr. Trump’s tax breaks petered out, earnings slumped and indicators were affected by the general malaise. Making things worse, the so-called “trade wars” began to take a toll on production and supply chains, while Mr. Trump continued to pursue a strategy of essentially dismantling the US-led multilateral business and global influence environment that preceded him, in favour of a more unilateral and personalised policy. Future historians might well see Mr. Trump’s presidency akin to Richard Nixon’s first term, which saw the end of the Bretton-Woods accord ushering an era of fiat currency domination. British investors were burdened additionally, with a Brexit deadlock, which funnelled uncertainty for the real and the financial economy.

So it somewhat of a conundrum that, against that dismal fundamental backdrop, the S&P 500 delivered its best year since 2013 and bond prices soared. Investors did not mind fundamentals or expensive valuations or trade threats, ploughing more money into risk assets. For a world that supposedly worries about high levels of debt, it is remarkable that Greece, a country that for the last decade has been at the precipice of bankruptcy, briefly joined the club of countries that get paid to borrow money, due to negative interest rates.

What was the key driver of returns? At the end of 2018, the US Federal Reserve had suggested that it would continue to increase interest rates. After a significant market pullback, in the first days of 2019, Fed Chairman Jay Powell capitulated, saying that the world’s de facto central bank would pursue interest rate cuts instead of hikes and an end to quantitative tightening. What was set to be a year of three hikes became a year of three cuts. After September, both the ECB and the Fed restarted their money-printing operations, adding more liquidity into the markets. A rally ensued, driving both bonds and equities near all-time high levels.



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2020: The Power of the Cycle (continued)

The environment – What the global economy looks like

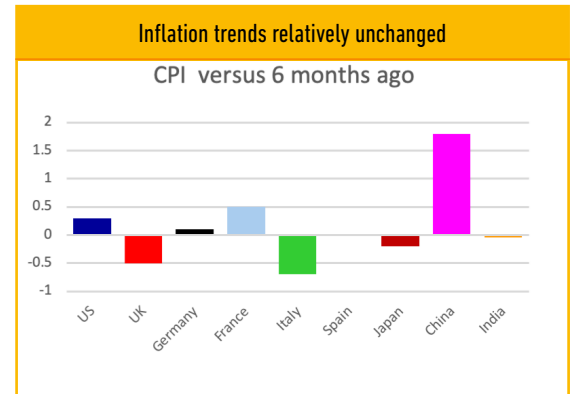
A short-term lukewarm picture

The global economy has seen some signs of stabilisation in the last few months of the year. Manufacturing indicators (especially the forward-looking and highly influential Purchase Manufacturing Indices) have shown some signs of stabilisation. Trade data also appear to be bottoming out, which could be good news for the ailing exporters, such as Germany and Japan. Inflation is still low, despite the honest efforts by central banks to rekindle it as a way to deal with mounting debt and restore a sensible structure between short and long term interest rates. However, it is not low enough to cause deflation, a sustained fall in the aggregate price level, which can hinder business decisions. A potential trade deal between the US and China could, over the shorter term, improve the business climate further. Central banks remain accommodative, which at least is conducive for capital spending. The picture is lukewarm, that of a nascent recovery, while earnings on the other hand continue to contract. Companies have shaved profit margins to compete in a low growth environment.

Longer term considerations a drag on growth

Over the longer term, our thesis that this is an environment of “Secular Stagnation”, holds. In this environment, growth remains tepid as consumers prefer saving over spending and investing. Financial Repression is probably exacerbating the situation, as it is specifically designed to boost financial assets, ignoring the fact that its effect on the real economy is minimal. This means that either its benefits are not reaching many marginal consumers, those who can't afford to buy stocks and bonds, or they are reaching consumers who would rather do just that, buy stocks and bonds through their retirement accounts (a form of saving), instead of buying goods and services. It is thus no wonder that demand-driven inflation remains so low.

There are other drags on growth, apart from reduced appetite to consume, probably a by-product of the global financial crisis.



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2020: The Power of the Cycle (continued)

East-West rebalancing

After the end of the cold war, the east began a race to catch up to the west in terms of growth. China is now the second biggest economy in the world, and by some measures the biggest. It's tangent economies, like Vietnam, Malaysia or even India are also on the rise. In an open global economy, the consumer rewards go to the countries with the best competitive advantage and the highest growth rates, which is why incomes in the west have stagnated over the past few years, while advancing in the east. In simple terms, the west might not be the tip of the spear any more.

High Levels of Global Debt

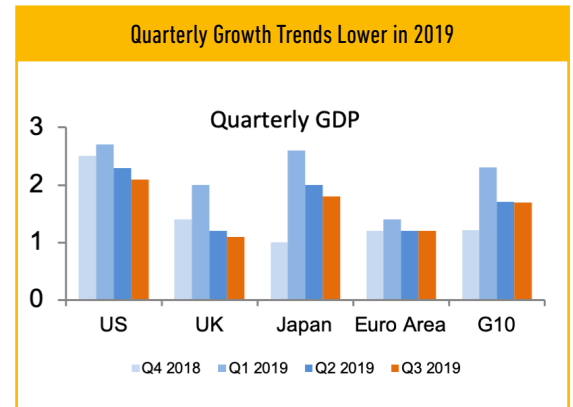
Global debt hit a record high of over \$250 tn in the first half of this year, led by a surge in borrowings in the U.S. and China, according to a report by the IIF. It is now 2.5 times the historical average, according to the IMF. As growth has slowed, countries which have made promises to their people that they will be a dominant economic power, as well as try to maintain onerous social contracts, have resorted to borrowing to make up for the shortfall. In the west, we have borrowed from the next two generations. The east has borrowed from the next one. Despite low yields, such levels of debt, especially when that debt has not been put to productive use, can further hamstring growth.

China Slowing Down

The effects of the Chinese transition from a manufacturing to a consumption economy have not been well documented. Officially, growth has slowed to 6%. However, taking into account manufacturing and service PMI numbers, true growth could be as low as 2-3%, akin to the other big economies of the world. This has had a ripple effects on exporters to China, mainly Japan and Germany, both of which have flirted with a recession in the past year. The transition is not a short term consideration, and could act as a drag to global growth for years.

Demographics

80% of economic growth is due to demographics. 50 years ago, the average woman would have five children. Now the number is exactly half (2.5). For the three biggest economies in the world, the US, China and the EU, the numbers are even worse, with 1.8, 1.4 (despite scrapping the one child policy) and 1.6 children respectively. With longevity rising, it means that there will be a reduced workforce working to support a rising number of retirees.



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2020: The Power of the Cycle (continued)

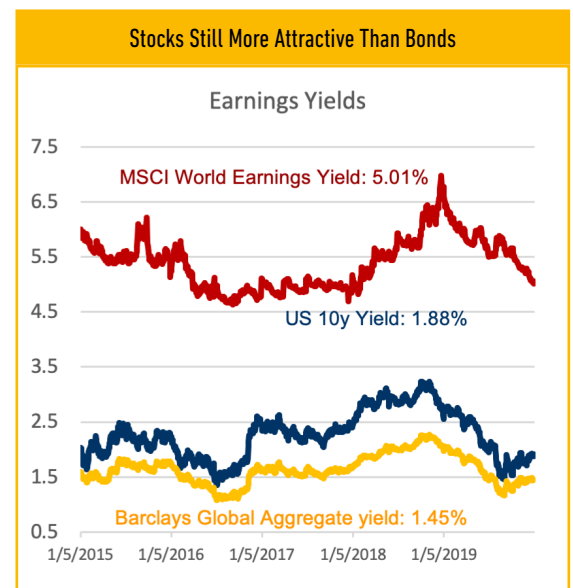
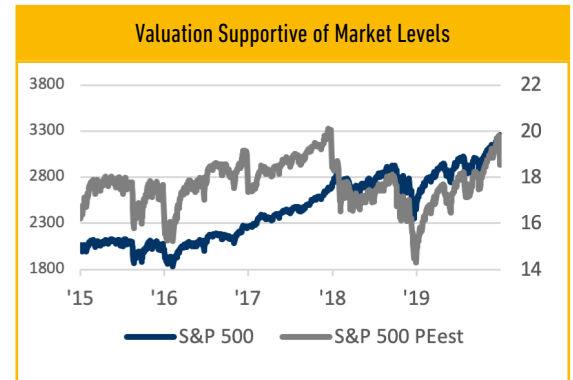
This has been putting significant strains on healthcare and pensions, threatening social contracts, especially in Europe. It is no wonder that governments have resorted to borrowing to make up for the shortfall, but even non-inflationary conjuring of money cannot be a long term substitute to growth.

Competition

As growth slows, it is a natural reaction for people to want to compete more fiercely for a piece of a shrinking pie. However, the spirit of competition also brings enmity towards competitors. This is why many countries, spearheaded by the US and the UK, have opted to renegotiate their trade connections to the world, in hope of an edge. Especially these two have realised that the Post-WWII world order is not the same in an era where Chinese dominance is expanding. Thus, their policy to share growth in exchange for influence may not work as much as it should any more. The problem with this approach is that until everything is renegotiated successfully, barriers to trade are erected. From ancient times it was known that unhindered trade helps both sides of the border. Conversely, barriers hurt both sides. So far, the US has imposed tariffs on more than \$360bn (£268bn) of Chinese goods, and China has retaliated with tariffs on more than \$110bn of US products. Global growth has taken at least a 0.5% hit, if not more, as countries refuse to compete with one another. The positive effects of global growth competition are short lived. The US economy indeed benefited for a year and a half, after Mr. Trump's 2018 tax reform. However, the move meant repatriation of dollars, especially from the east and Europe, which led those economies to a downturn, reducing demand for American products as well. Now the US economy is slowing down as well. In a globalised world, there's no isolation, at least not in the long run.

But risk assets are sky-high...

It is a bit of a wonder to see the same theme repeating itself for a solid decade. Gloomy predictions based on worsening fundamentals at the beginning of the year, and then performance ripping those outlooks to shreds. Fundamental-based active investors were left behind by their benchmarks and ridiculed as over-cautious, while 'go with the flow' low fee passive portfolios have profited. It is a case of what psychologists call "Cognitive Dissonance".



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2020: The Power of the Cycle (continued)

On one hand, we expect the wisdom of fundamentals, theory, and experience to hold true. But on the other hand, a surge in asset prices uncoupled from fundamentals and turbo-charged by uber-accommodative monetary policy challenges this orthodoxy.

Is 2020 the year where the “chickens come home to roost”? We believe the question itself is wrong, same as it was in 2019, 2018, 2015, 2014 and so on. 2019 was not a guide in irrational exuberance but rather in the rationality of how powerful financial repression is to underwrite risk taking, propelling financial assets, even against deteriorating fundamentals. As long as this is the case, the financial cycle remains intact and prevents economic slowdowns or even recessions from turning into crises.

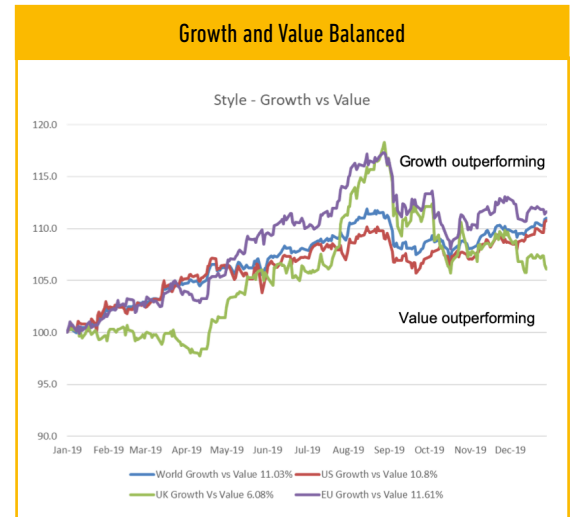
So the question becomes: is there something more powerful than central bank printing which could upend the cycle, or at least put a significant dent on returns? What can be more powerful than the driving force which restarted capitalism a decade ago. To answer this, we have taken the major risks for the economy and divided them in four categories. Those investors know and should, or should not worry about, those investors are less cognisant of and should worry about, and those that are still to be identified.

The Risks You Should Be Talking About

Known Knowns: Things investors know and should worry about. These risks are well known and somewhat priced in, however their extent is unknown so they always feature high on our radar.

Trade Wars

Trade wars, especially if they continue to escalate, can pose serious threats to global growth. In the immediate economic sense they will disrupt supply chains. However, more important is the long term damage to consumer trust for key brands. The example of the Huawei ban last spring, which shook western confidence in the Chinese brand is stark. As an immediate reaction, Chinese consumers shifted en masse from Apple towards what they now consider to be a national brand. This, in fact, is the real risk, the emergence of an “us versus them” mentality, which can severely hamstring marketing and sales efforts across the globe.



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2020: The Power of the Cycle (continued)

Extended trade wars can, eventually, weaken the case for central bank support for risk assets.

China Slowdown

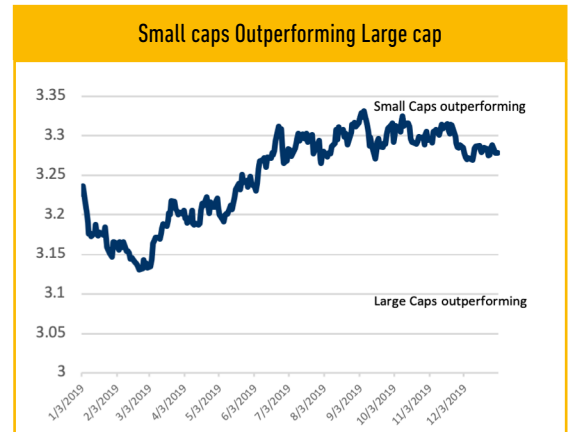
The Chinese economic transition is well documented. The lack of visibility over that transition is also clear. The problem is that because of it, investors have no real idea what the velocity of the Chinese slowdown is, what are the effects of clamping down on shadow banking, to what extent is the “Belt and Road” initiative succeeding or failing or how are China’s efforts to internationalise the Yuan proceeding. What they do know, is that key supplier economies, Germany and Japan, are flirting with recession. Also, they have taken stark notice that, in the absence of the marginal consumer for capital products, China, global production especially of high margin and heavy machinery has ground to a halt. When the slowdown of the world’s purveyor of economic growth spills over to other countries, exacerbating the divide between fundamentals and runaway risk asset prices, it is conceivable that eventually investors might be concerned that future earnings simply do not support current prices, and sell their assets.

Valuations

As earnings stagnate or even fall, equity prices have risen. This means that valuations for stocks are rising. While there’s no clear fundamental principle as to why investors should adhere to a P/E average (why is 15 considered “fair”?) the correlation between valuations and appetite to invest is well documented. We believe that while equity valuations do not generally lead to sell-offs, they can however put a dent on the upward trajectory for stocks.

Bond Prices

If equities are entering “expensive” territory, bonds are well into what some might even consider “bubble” territory, at least by historical standards. The problem with this statement is that expensive bond prices are not driven by consumer demand, but rather central bank strategies. Unlike consumers, central banks don’t “sell-off”, or, more importantly, they do not worry about return on their money, since they are the only institutions that can print more of them. We are less worried, thus, about the bursting of a bond bubble, and more worried about the long term effects of central bank manipulation for the bond markets themselves. Already, in Europe, primary bond dealers have all but ceased operations, as the central bank gobbles up most government and corporate bonds.



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2020: The Power of the Cycle (continued)

By repressing yields, those vehicles that rely on fixed income or liability-matching are forced to take on more equity risk, which could increase losses in a sell off. This forces central banks to further repress volatility, creating a vicious and endless cycle of market manipulation, which at its end could see the erosion of trust in central banks, especially if they decide to break the cycle off.

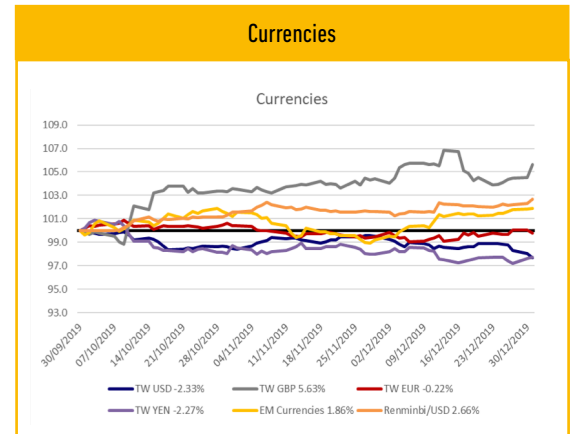
Known unknowns: Things investors pay less attention to, but they should still worry about. These risks may be underpriced by investors and should merit caution.

Currency Wars

We have long worried about the threats to the independence of central banks. To be certain, after the 1980's when central banks started to become independent, there have always been efforts to control interest rates as a way to promote internal and external political agendas. After 2008, when central banks acted independently and in concert to bring the global economy back from the brink, efforts by political leaderships to reign in their power have intensified. The key risks is that Mr. Trump's pressure on the Fed, German pressure on the ECB, or nationalist pressures on the BoE succeed to turn the central banks into a currency depreciation mechanisms. This could truly erode trust in central banks and usher a more insidious form of trade wars, currency wars, from which all parties may lose.

Undoing of global alliances

The post-WWII order was based on a string of global alliances, spearheaded by the United States. International organisations, like NATO, the UN, the EU, the IMF, the World Bank or the WTO, have all been directly financed (or in the case of the EU indirectly) by the United States. The latest US presidency has opted for more bi-lateral relationships. As a result, in the last three years, WTO's arbitration mechanism has been defanged, the EU is in disarray, the UN increasingly irrelevant, and the French President has called NATO all but defunct. The question for investors is: what will the effects of five more years of that be for politics, trade and wider policy decisions? This creates a significant unknown, which could even outweigh trust in the ability of central banks to mitigate risks.



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2020: The Power of the Cycle (continued)

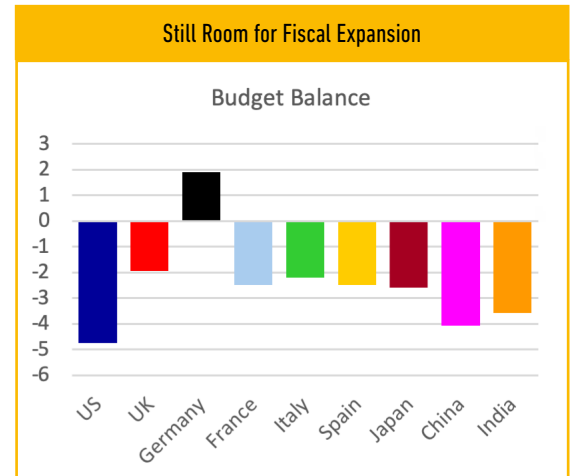
Have we also created a bond bubble?

Low growth and aggressively dovish central banks are all positive for bond prices. Despite a recent selloff, \$11 tn in global bonds continue to trade with a negative yield. The spread between the US 10 Year Treasury rate and the Fed Funds Rate is negative and at the lowest level since the 2008 crisis. Germany is paid to borrow for 30 years and the 10 year Bund is at the lowest level since East Germany re-joined the west. The 10-year yield for Greece, a country below-investment grade and no with control over its currency which would help to pay off its debt, is almost 0.4% lower than the yield on the respective US bond, the only country whose “reserve currency” status allows it to print money with little or no inflationary implications. Recently Greece joined the countries that borrow at a negative yield, i.e. they are paid to borrow.

Meanwhile, borderline investment grade bonds (BBB) have surpassed the \$7 trillion mark, suggesting that a lot of companies have been taking advantage of low rates, building up their debt. Unlike countries, most of which can print enough money to pay for their debentures, and who are never really ‘profitable’ enough to pay it off over the longer term (incredibly poorer countries who are forced to curtail spending have higher primary (ex-interest) surpluses), companies are expected to reduce their debt over time, as big debt ratios are usually a red flag for equity investors.

Why are investors flocking into bonds despite low yields? Partly because of the reversion in central bank rhetoric into a more dovish territory, and apparent lack of inflation, which have pushed yield curves down. Investors also assume people are flocking in bonds. The Fed has already cut rates twice this year and is widely expected to cut again by December. In September the ECB decided to restart QE, planning to buy €20bn per month for an indefinite period.

Still, negative yields make little sense. Investors lending money to the German government for 10 years are assured to lose 0.5% each year, or 5% if they hold until maturity. Why would anyone buy an investment guaranteed to lose money?



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2020: The Power of the Cycle (continued)

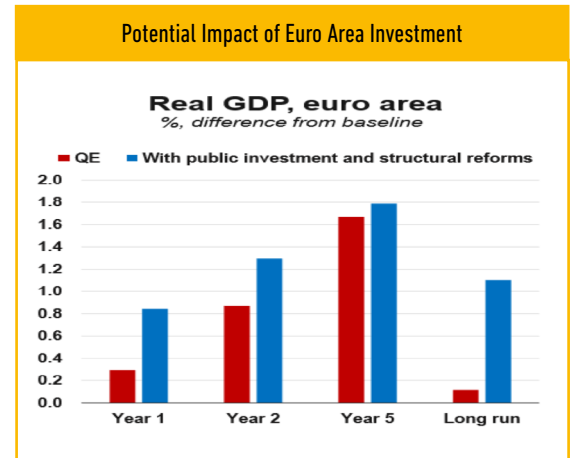
Europe

Monetary unions have tended to eventually fail throughout history, and the European Monetary Union, whose design flaws have been exposed multiple times, is not a strong candidate to be an exception. Our world is a monetary one, which means that countries which control their currency can always print more, and may never go bankrupt, in the technical meaning of the world. Their risk, is a currency risk. But for European countries, which do not control their currency and cannot print money to meet their debts individually, they must rely on ECB quotas to meet their financing obligations, thus running higher risks of bankruptcy. Apart from Greece, Italy, Spain, Ireland and Portugal still have weak economies and could eventually relapse, especially if the global economic downturn becomes more pronounced. In the case of a major EU economy going bankrupt, it is doubtful that printing by major central banks could make a significant difference.

Populism

Populism is a stealth enemy. While easily observable from a distance (say another country) it is significantly more insidious from up close, as it plays to inherent and built-in biases. The history taught to most children all over the world, for at least the first 10-16 years of their lives is one where they are descendants of a great nation, which has only in the past defended or asserted its natural superiority against other nations. Thus, when in a slow growing world politicians promise a return to a "glorious past", those biases kick in and emotion overrides critical thinking. We believe that as growth slows down, populism will continue to rise, as the promise that people might not have to suffer from a contracting "growth pie" can prove tantalising. Electing increasingly populist leaders further risks the breaking of the global multilateral order, which in turn has grave effects on established international institutions which mediate differences, or limit the central bank's abilities to prevent crises from breaking out.

Unknown Knowns: Things investors should not worry about as much as they think. This is a category of items that dominate the news, yet they may not be as damaging for risk assets as they may appear.



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2020: The Power of the Cycle (continued)

Brexit

Brexit itself may be damaging for supply chains in and out of Britain as well as potentially dangerous for the City's status as a global financial centre. However, we need to make note of some things: a) recent statements and concessions by Europe indicate that Frankfurt or Paris are not ready to replace London, and that transition will take time b) while trade treaties tend to take long, it is useful to remind investors that the UK and Europe already have a trade treaty in place. The question to be answered, and it very well could within a year, is "what is the price for limiting free movement?". The real danger of Brexit is sparking nativism, which in turn would turn off talented workforce from the UK, ultimately causing a competitive disadvantage. But all these possibilities are still very much in play, depending on what stance the new government will take.

US Elections

With the possibility of Elisabeth Warren or Bernie Sanders assuming the presidency diminishing, the question for markets is simple: will the American public elect a President who will resume globalisation or prefer one that opts for bilateral relationships? And if they do, will they give him or her unfettered power, or will they opt for divided government? These questions are important from a policy perspective. While the election might not cause a short-term concern, further breaking of the post-WWII world order could have significant implications for the ability of the central banks to convince investors that they can cooperate to successfully suppress risks.

Oil prices

A final key risk, which emerged after the US successfully killed a top Iranian general in Iraq. Long term, geopolitically, Soleimani's death may prove an important moment. It fuelled Shia resentment of US forces in Iraq, with the local parliament attempting to delegitimise their presence, further driving Iraq into the embrace of Iran. Iranian leaders felt that they would now be justified to restart uranium enrichment. Exciting as this story may be, it will probably have little effect on risk assets, unless things escalate dramatically.

For one, while oil prices spiked, they are still beneath last April's levels. West Texas Crude at \$65 may stoke some short term inflation (central banks tend to ignore oil prices when considering inflation), but at current depressed CPI levels this is not a threat to central bank accommodation, the key driver of risk prices.

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2020: The Power of the Cycle (continued)

Unknown Unknowns: The gravest category of risks is those we do not know of. Our approach to them is simple: Instead of obsessing or magnifying risks that markets may have not picked up on yet or even go so far as inventing “Black Swans”, we monitor the news and consider one question: does this threaten the cycle? If the answer is “probably not”, we would set it aside.

Conclusion

Trend growth is low, especially in the west, and we expect that this theme will continue throughout the foreseeable future. At first economies made up for the shortfall real growth with credit, and then, to maintain the prices for financial assets, they flat out printed new wealth, funnelled at stocks and bonds. An abundance of liquidity itself is good, as it effectively prevents recessions from spiralling into crises. Whether this means a departure from fundamentals, or not, quantitative easing and scarcity of financial assets is the name of the game, the “only game in town” as the famed economist Mohamed El-Erian once quipped. We are forced to consider all scenarios. However, as time passes, we suspect that what may override the faith in the central banks’ ability to underwrite risk, will be a confluence of some of the above risks, possibly triggered by “black swan” events. We will continue to monitor closely, but until the data in front of us confirm that we should take a more defensive position, we will continue to consider the current cycle a going concern, not easily threatened.



GEORGE LAGARIAS
Chief Economist

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Asset Allocation

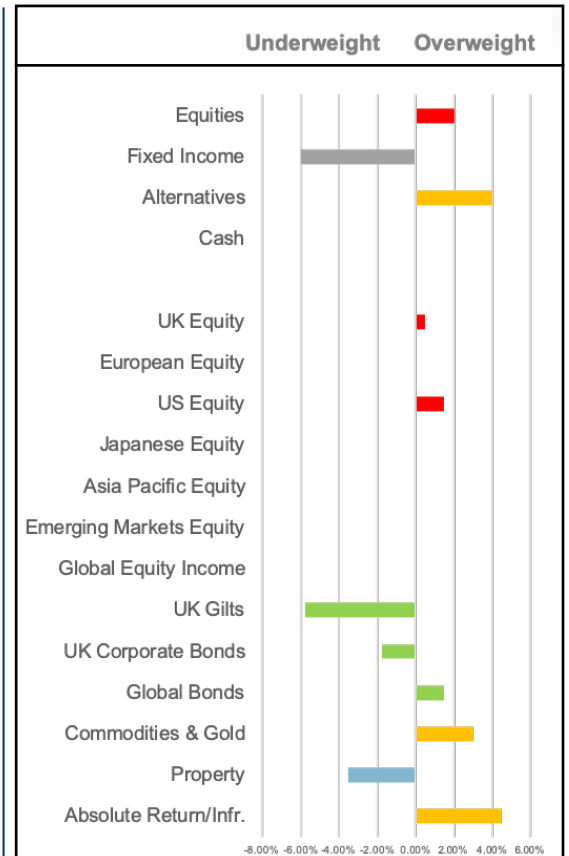
Global economic data is mixed. On the one hand, leading indicators and trade indices suggest that the global economic deceleration might be ending, and growth bottoming out, at least for this part of the cycle. On the other hand, manufacturing data persistently indicates contraction, especially in capital goods orders, suggesting that China continues to both transition and slow down, causing ripple effects to its closest trading partners. The US has joined the cohort of large countries which now see their economy slow and is slightly lagging the cycle of others.

Global inflation remains at bay and unemployment in developed markets is near all-time lows, however we could see some pressures ahead as companies eat into their backlogs. Consumption is dented and capital expenditure is suffering.

Risks for growth are persistent

Trade wars, Brexit uncertainty and the Chinese slowdown, along with the fact that the cycle is well into its 10th year, may unnerve investors. On the back of this feeling, central bank accommodation is increasing, along with investor willingness to buy on a dip, despite the Fed pausing rate cuts, as the world's de facto central bank has increased the pace of QE. This has helped risk assets break new highs, ignoring tepid fundamentals.

Our latest investment committee in January 2020 felt that, although a little more clarity has been achieved (mostly on the Brexit front), the sheer availability of cheap capital and scarcity of risk assets, create favourable demand/supply dynamics for equities. Therefore, we decided to add 2% to our allocation in UK small caps, from cash. We don't maintain strong geographical preferences at this point, awaiting for more visible catalysts going forward. We still believe that the cycle, for the time being, remains intact despite increasing signs of maturity.



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Asset Allocation – Risks

Risk Monitor

Global economic growth continues to be tepid, albeit bottoming out. Markets are mostly focused on risks stemming from protectionism, the European and Chinese economic slowdown and global debt levels. As US fiscal policy initiatives petered out, central banks once again picked up the growth baton and became more accommodative. On a more tactical basis, investors focus on the willingness of central banks to continue printing new wealth. However, political pressure on central banks to keep currencies cheap is undermining their independence.

Globally, very low bond yields have been causing investors some concern. However, a recent rebound has moved the conversation away from the “building bond bubble”

In the US the main risk is a further economic slowdown, after Q4 2019. Additionally, investors are now worried about the impact of a change in the Presidency next year, the possibility of more split government, as well as illiquidity in the short-term debt market. Finally, there are worries as to whether the Fed will be able to keep up with the market’s expectations for low interest rates.

In the UK, the outcome of the election on 12 December helped investors gain more visibility on the Brexit path ahead. Risks now lie in achieving a trade deal in record time.

In Europe, fears have shifted from Italy to the ailing German economy. Investors are also worried about the fate of Deutsche Bank and Non Performing Loans across the Eurozone, as Italian yields are very close to those of Greece. The new head of the ECB intends to maintain levels of accommodation, but is considering raising interest rates back up to zero.

In China the slowdown persists, but some evidence suggests a possible rebound going forward.

We feel that short-term systemic risks are mostly manageable as liquidity is still ample. While a recession is drawing nearer, a “crisis” is not in the horizon. We are closely monitoring the increasing number of headwinds, the confluence of which could upend the economic and financial cycle.

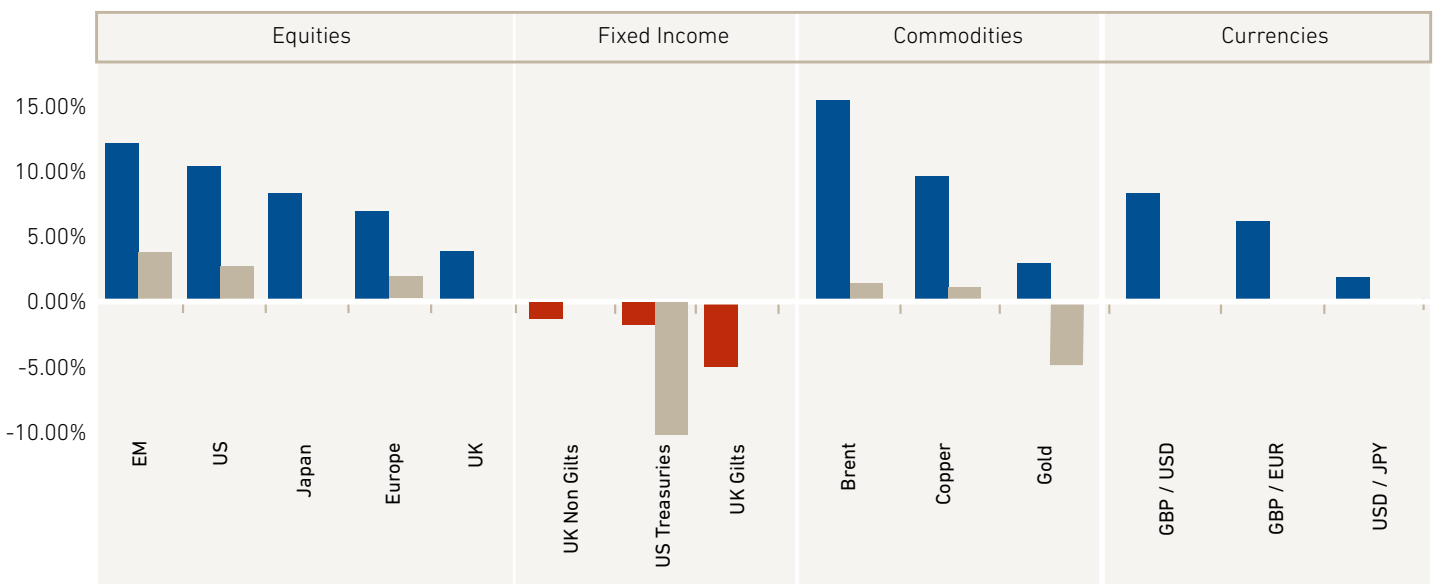
- Trade Wars
- Viability of an UK/EU trade deal in 2020
- Bond Bubble
- Chinese and Global Slowdown
- Headwinds to global growth

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Economies and Markets

	Currency	Q4 2019	Q3 2019	Q2 2019	Q1 2019	YTD	
Equities						local	GBP
UK	GBP	3.4%	0.0%	2.8%	9.5%	18.0%	18.0%
US	USD	2.6%	3.8%	6.6%	11.5%	33.0%	29.8%
Europe	EUR	1.7%	1.4%	8.1%	8.1%	28.5%	21.8%
Japan	JPY	-0.1%	4.4%	2.7%	5.0%	19.1%	16.7%
Emerging Markets	USD	4.1%	-2.4%	2.8%	7.9%	20.5%	17.5%
Fixed Income							
UK Gilts	GBP	-4.2%	5.6%	1.7%	3.4%	7.6%	7.6%
UK Corporates	GBP	-0.8%	3.3%	2.1%	4.1%	10.1%	10.1%
Global Bonds	USD	-8.0%	3.8%	7.4%	-0.6%	3.0%	3.0%
Other Assets							
Gold	USD	-4.7%	9.4%	13.1%	-1.1%	21.8%	18.9%

Asset Class Performance in Q4 2019



Source: Mazars Calculations, from 30/6/2019 to 30/9/2019

■ = Local ■ = GBP

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Economies and Markets

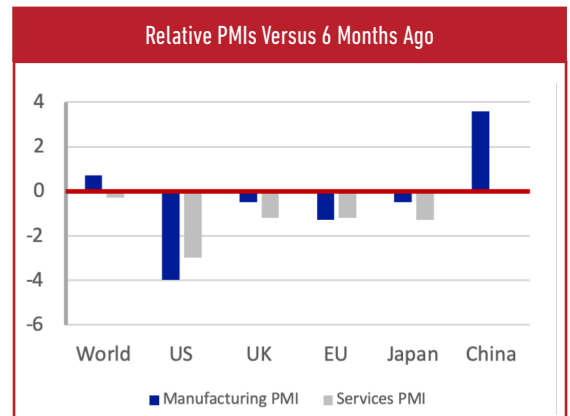
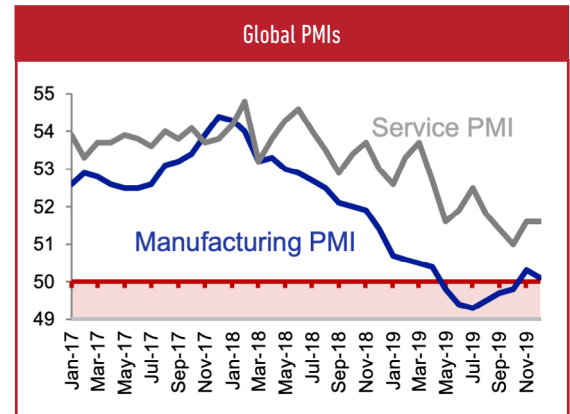
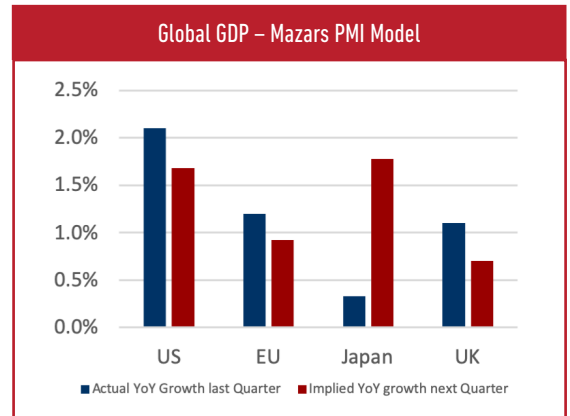
GLOBAL

Global equities rose +9.6% in local terms which was equivalent to a 1.8% growth in Sterling terms. Healthcare was the best performing sector globally, closely followed by IT, both of which returning over 14%. Global stocks are trading at 17.33x forward earnings, 14% above their 10-year average of 15.22x.

The global economy has seen some signs of stabilisation in the last few months of the year. Manufacturing indicators (especially the forward-looking and highly influential Purchase Manufacturing Indices) have shown some signs of stabilisation. Trade data also appear to be bottoming out, which could be good news for the ailing exporters, such as Germany and Japan. Inflation is still low, despite the honest efforts by central banks to rekindle it as a way to deal with mounting debt and restore a sensible structure between short and long term interest rates. However, it is not low enough to cause deflation, a sustained fall in the aggregate price level, which can hinder business decisions. Central banks remain accommodative, which at least is conducive for capital spending. The picture is lukewarm, that of a nascent recovery, while earnings on the other hand continue to contract. Companies have shaved profit margins to compete in a low growth environment.

Outlook

The cyclical rebound for the global economy may still be on the cards, albeit 6-9 months later than expected. Global economic organizations, like the IMF and the OECD continue to downgrade global economic forecasts, especially for Europe. Having said that, risk assets overall are well supported by central banks. A potential trade deal between the US and China could, over the shorter term, improve the business climate further.



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Economies and Markets

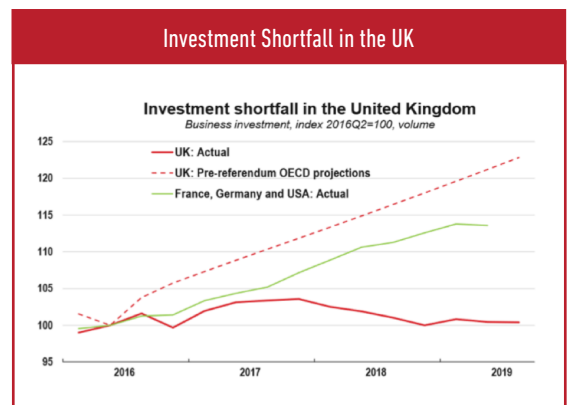
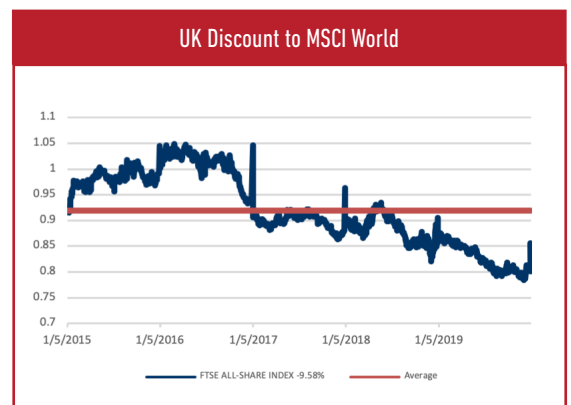
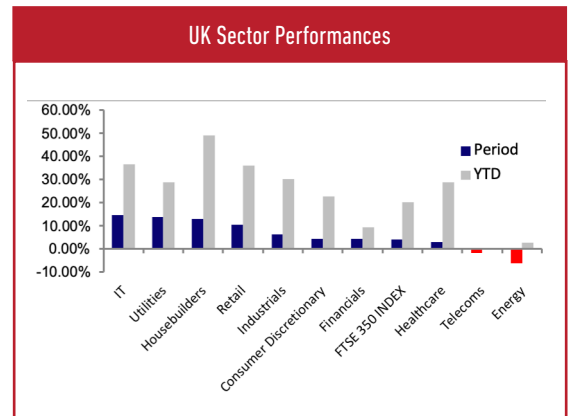
UK

UK stocks rose 3.4% in Q4, led by IT and Utilities, while Telecoms and Energy were the two notable drags on performance. The UK 10y Gilt ended the quarter at 0.82%, up just over 35 basis points. UK stocks trade at 13.51x earnings, 2% above their long term average of 13.21% and at a 22% discount versus the MSCI World.

The UK economy continues to tread water, as investment levels remain low, a result of a wider global growth slowdown as well as ongoing Brexit uncertainties. Manufacturing has been weak, as the Chinese slowdown continues to affect production of capital goods and internal demand for investments remains tepid. The services sector fared somewhat better, but consumers have shown restraint. Q3 year-on-year growth has slowed to 1% and signs are not very positive for Q4. Construction and real estate continue to detract from growth, as spending decisions have been consistently deferred over the past three years. There were, however, some silver linings. Unemployment remains close to record lows and wage growth has continued to outpace inflation for the last few months. The central bank has been accommodative and markets have welcomed the appointment of Andrew Bailey as Mark Carney's successor, convinced that he would not take a more hawkish stance.

Outlook

The outlook for the UK economy is slightly improved after the election. Manufacturing is set to remain weak, as the Chinese slowdown persists and producers have already built up inventories that now have to be sold. The resounding mandate handed to the Tory party broke the Brexit deadlock and provides some clarity at least as far as the next few steps are concerned. The next big challenge will be achieving a trade deal with the EU in record time. We believe that this development will at least clear the air regarding some major spending decisions. We also expect risk assets to react positively in the next six months. Beyond that, performance will probably depend on the outlook for a trade deal with the EU.



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Economies and Markets

US

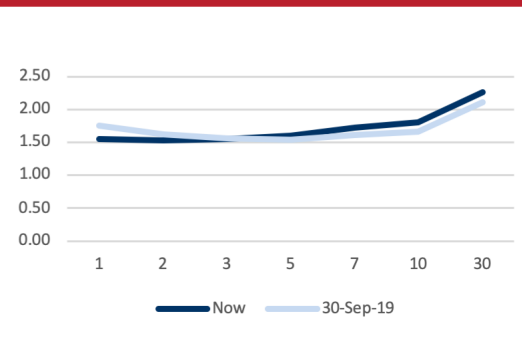
US equities rose 10.4% in Q4 2019 in US Dollar terms, or 2.6% in Sterling terms. The rise was led by Healthcare and IT, whilst Homebuilders and Utilities although positive lagged. The US 10 year rose 28 basis points to 1.92%. US stocks trade at 18.73 x forward P/E, 17% above their 10 year average and at an 8% premium to the MSCI World.

The US economy is slowing, along with the rest of the world, as the effects of Mr. Trump's 2018 pro-cyclical stimulus –and the period that preceded them- have petered out. Despite a good amount of Dollar repatriation, output growth, which peaked in mid 2018 at 3.2% now stands at 2.0%. S&P 500 earnings fell by 2.7% for Q3, slightly better the median analyst expectation of 4.7%. Consumer sentiment is still high by historical standards, and consumption patterns are not too worrying, but overall consumers are worried over the effect of trade wars and have been reserved about their purchases. Manufacturing has slowed, along with the rest of the world, despite companies building inventories and eating into their backlogs. The services sector is faring somewhat better, with some data indicating a nascent rebound. Employment levels are high, with both unemployment and underemployment falling to multi-year lows. Due to the confluence of internal and external pressures in the economy, the Federal Reserve slashed interest three times in the year and indicated a pause thereafter.

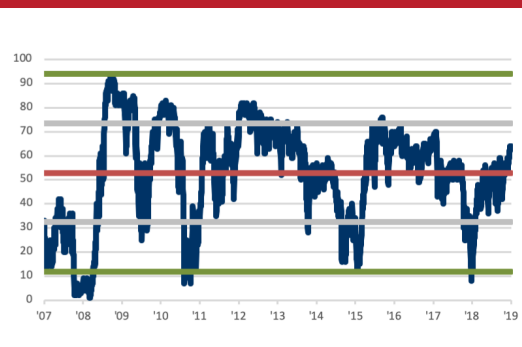
Outlook

The US economy is slowing at a rate commensurate to that of the rest of the world, as the benefits from last year's stimulus failed to improve trend growth. However, as the Fed remains dovish, the outlook for US assets, which also feature very high ROE companies continues to remain upbeat, at least relative to the rest of the world.

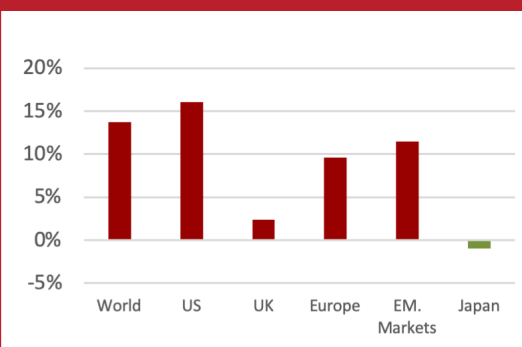
US Yield Curve Marginally Steepens



52% US Stocks above 200d MA



Relative valuation: P/Es vs Average



04

Economies and Markets

EU

European equities grew more than UK but less than US counterparts in Q4 2019. Rising 6.6% in local terms, or 1.7% in Sterling terms. Europe was led by strong Retail and Materials sectors whilst Energy and Telecoms provided drags on growth, with the Telecom sector making a loss over the quarter. EU stocks trade at 15.36x forward earnings, 9% above their average and at an 11% discount versus the MSCI World.

Growth conditions in the Eurozone still lag the rest of the world, with GDP figures and PMIs consistent with an economic slowdown. The IHS Markit Eurozone Manufacturing PMI continues to trade below the 50 level, with the December reading at 46.3, up slightly from its recent trough but still indicating ongoing weakness in the sector. Output and new orders declined at an accelerating rate, presenting a lower probability for a cyclical rebound. Furthermore, spare capacity has led to further job losses, implying the weaker economic backdrop is starting to weigh on employment.

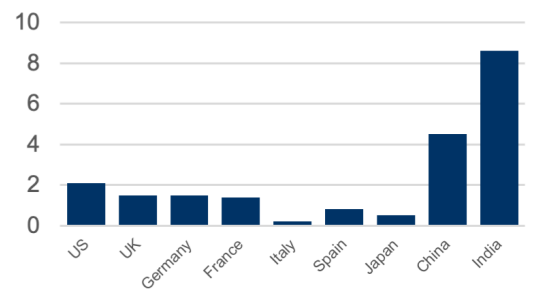
ECB chief Christine Lagarde and team will be conducting a strategic review of their monetary policy this year; the second review in the central bank's history. One key area investors will be watching is the price stability objective. Philip Lane, ECB Chief Economist recently said the objective should be "symmetric", which could mean the bank allows inflation to remain above the 2% target for some time before hiking rates.

Inflation in Europe remains below target, despite extremely loose monetary conditions, with the ECB deposit rate at -0.5% and QE at a pace of €20B per month. The unemployment rate for the Euro Area remains near cycle lows at 7.5%.

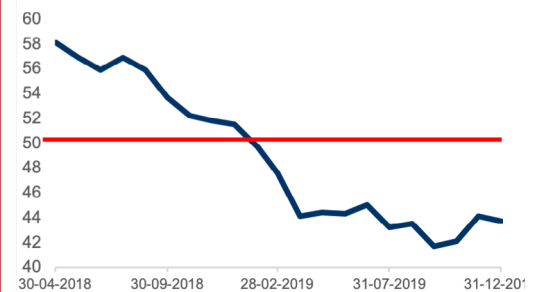
Outlook

External uncertainties persist for the Eurozone. These include geopolitical risks, such as Brexit uncertainty or potential auto tariffs, which could weigh on demand. Overall we remain neutral on EU risk assets.

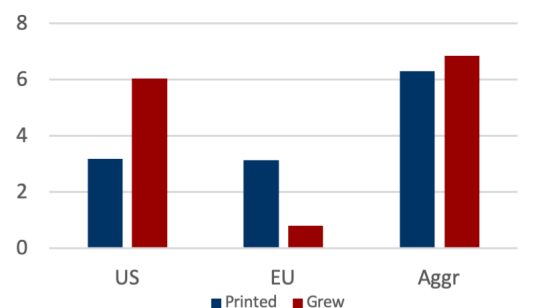
Eurozone inflation remains absent



German Manufacturing PMI



Europe has printed more than it's grown since 2007



04

Economies and Markets

EM AND JAPAN

Japanese equities fell 0.1% in Sterling terms, but this was caused by currency effects, as they grew 7.6% in local terms. Emerging Market equities had a strong quarter posting 12.1% growth in local terms, or 4.1% in local terms. Japanese equities trade at 14.61 x forward earnings, a slight 1% discount to 10-year average, whilst Emerging Markets appear more expensive trading at 12% above their historical average at 13.31 x forward earnings.

Japanese manufacturers ended 2019 on a disappointing note as the manufacturing sector further deteriorated in December. The Jibun Bank Japan Manufacturing PMI was 48.4 in December, down from 48.9 in November, indicating an eighth consecutive deterioration across the sector. Exports from Japan declined -7.9% YoY marking the longest run of declines in exports since 2016. The unemployment rate in Japan declined to 2.2% in November 2019 from 2.4% in the previous month, well below market expectations while wage growth remained unchanged at +0.5% YoY.

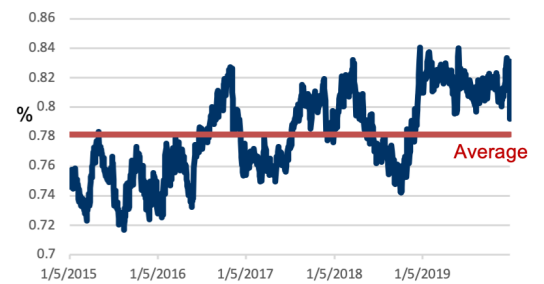
Markets breathed a sigh of relief as a 'phase one' trade deal was confirmed by officials in both Washington and Beijing as China committed to buying at least \$40bn of US agricultural goods annually, tighten protection for US intellectual property and ban the forced transfer of technology from US companies. In exchange, the US agreed not to proceed with a new escalation in levies on \$156bn of Chinese consumer goods, and decided to cut tariffs on \$120bn of Chinese imports that were introduced in September to 7.5% from 15%. Washington still maintains 25% tariffs on about half of all Chinese imports, worth about \$250bn, which were introduced since the trade war began in March 2018.

China's industrial output rose to 6.2%, the sharpest yearly growth in industrial output since June, as government support propped up demand. The manufacturing sector posted expansion for the second straight month in December. The Official NBS Manufacturing PMI in China was unchanged at 50.2 in December 2019, slightly above market expectations of 50.1 as output growth accelerated, new orders rose and growth in exports rebounded.

Outlook

We are neutral on both Japan and the Emerging Markets. Japanese risks assets continue to suffer from tepid growth and long standing structural deficiencies. Emerging markets seem more attractive, based on performance, but high valuations versus their averages continue to put a cap in investor expectations.

Valuations relative to MSCI World



GEORGE LAGARIAS
Chief Economist





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