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Back to School

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"You can't learn in school what the world is going to do next year" - Henry Ford

In the global investment strategy calendar there is only one period of time that can compare with the turn of the year in terms of importance... and that is the back to school period.

I hope everyone enjoyed a good summer holiday. Certainly a well-timed purchase of Turkish lira or Argentine peso may have transformed your holiday spending capabilities, but the really big foreign exchange trend during August was centred around the US dollar. We have talked before about a rampant dollar being a challenge for prospects for many financial markets, and August showed a clear manifestation of this. For example, the fall in broader pan-European indices during August nearly wiped out the prior year-to-date returns. Meanwhile, emerging markets went from relative performance heroes in July to bottom-of-the-pile 'zeros' during August. It certainly would not have been pleasant for anyone watching from a beach.

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That is not to say that everything underperformed during August. A plethora of main US market highs and technology stocks - including European sector peers - also performed well, deepening further the outperformance of more traditional growth sectors versus more value centred ones. Thematically, the more trying times unsurprisingly also saw dividend heavy corporate names perform better than broader indices. However, these were slim pickings in the wider scheme of things.

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So where do we go next? In last month's update we hoped that political leaders would not let the warm Northern Hemisphere temperatures get to their heads. The slightly better performance of the Pound during August was aided by a nudging up of interest rates and a resumption of Brexit talks. Appraising the latter, the occasional positive headline about some progress between the British government and the European Union showed that UK being once again at the bottom of the most recent global fund manager sentiment survey, is more of an opportunity than a threat for more UK domestic centred assets. Brexit remains a highly divisive issue, with many hurdles still to clamber over, but a compromise 'soft Brexit' deal still looks to be the most likely outcome.

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Globally, the outlook for world trade remains the greatest concern, but at least bilaterally in North America, the United States and Mexico forged an agreement with the hope that a trilateral agreement with Canada will follow. To me this outcome reflects the building influence and proximity of the US midterm elections in early November, which threaten to clip the political flexibility of the current administration. For global markets, any budding entente cordiale between the United States and China would be deeply welcomed - and likely to lead to a notable outperformance of assets in the emerging markets and Europe. Despite the deep trade concerns apparent at the moment this is not an improbable outcome. Deep down, all global political leaders know that for anything other than a short time period, heightened trade barriers are an economic lose-lose.

Such a loss counts for double during an economic recession, naturally. Despite a slow shift up in interest rates and bond yields across many geographies during 2018, I remain relatively unmoved by the predictive power of the flattening yield curve in the United States, which some have highlighted as predicting economic gloom in the near future. There is still plenty of potential in the world - as evidenced by the still generally positive yield pick-up from owning equities compared to fixed income alternatives - especially if disruptive outcomes to the current world trade and Brexit debates can be avoided. As with all returning school children, it is time for global policymakers to knuckle down to some serious hard work again. Diplomacy classes, anyone?

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