

Harbour Viewpoints

ASR notes on the global markets

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Absolute Strategy Research (ASR) is one of Harbour's providers of independent global research. ASR specialises in quality, independent and impartial macro-strategy research, which we use to challenge and inform the Harbour team's thoughts on the world markets. Ian Harnett, Chief Investment Strategist and Co-Founder of ASR, recently spoke with the Harbour investment team. This note summarises his take on the overall state of the world markets.

Harnett highlighted a few key points on the overall state of the world markets:

- After a period of positive market momentum, Brexit has proved to be a widespread disruption. Britain voting to leave the European Union has piqued policy uncertainty, and equity risk premiums have not kept pace with this uncertainty.
- There is a challenge in investing in a world where interest rates are close to zero, and bond returns are converging with interest rates.
- Global growth is dull, neither accelerating nor decelerating. Asia Pac has been positive, but US performance has been weak. The Eurozone has recovered better than expected, however the full impact of Brexit still remains to be seen once the UK Parliament decides how to proceed.

Eurozone and the effects of Brexit

After a period of positive market momentum, Brexit has proved to be a widespread disruption. Britain voting to leave the European Union has piqued policy uncertainty, and equity risk premiums have not kept pace with this uncertainty. Ian Harnett highlighted the overdependence on monetary policy with low nominal growth.

However overall, he said the Eurozone economy had been surprisingly positive in a capex-driven recovery.

Harnett's key points about the effects of Brexit can be summed up as follows:

- The UK leave group is a loose coalition of people who believe that the UK could be the Singapore of Europe, and those who favour isolationist policies.
- To trigger Article 50 and leave, they will first have to have a Parliament which is prepared to trigger it. Harnett suggested that a general election may be on the cards, and there is no guarantee they will have a Parliament that is willing.
- Policy uncertainty has actually increased since the vote, rather than decreased.
- The UK has a massive current account deficit, and faces a period of low growth and increased funding costs.
- These economic challenges will lead to further weakness in the GBP, with a risk that sterling falls 20%.
- There is risk in small cap investments, where there is no way to protect via hedges in the UK.

US Economy

A positive point from Ian Harnett's talk was that, despite US economic weakness, they are not seeing lead indicators that point to a US recession. Weakness in the US economy can be explained by the strength in the USD over the past three years. This USD strength has been driving down industrial profitability, with industrial sectors like oil particularly challenged. Overall, the US economy is one to watch as its importance increases in the post-Brexit world.

World dependency on China and USD

Harnett's take on China's role is that the market has been too pessimistic about the Chinese economy, where liquidity conditions are far easier. The USD drag on Chinese exports has been reversed, and the weaker USD can provide monetary and fiscal stimulation. Overall, China could be an engine of growth to counterbalance the uncertainties and weakness of the Brexit vote.

Asset Allocation

Harnett's feeling on asset allocation was there were risks that Brexit strengthened the US dollar, squeezed commodities, squeezed activity and limited multiple expansion. However he said that earnings are not the risk many currently think they are. Brexit and a stronger USD will drive a preference for companies with growth and quality over value.

A challenge lies in the fact that interest rates are close to zero, and bond returns are converging with interest rates. According to Harnett, global return forecasts are converging at close to zero. This put more onus on fund managers to add value.

Harbour Asset Management

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