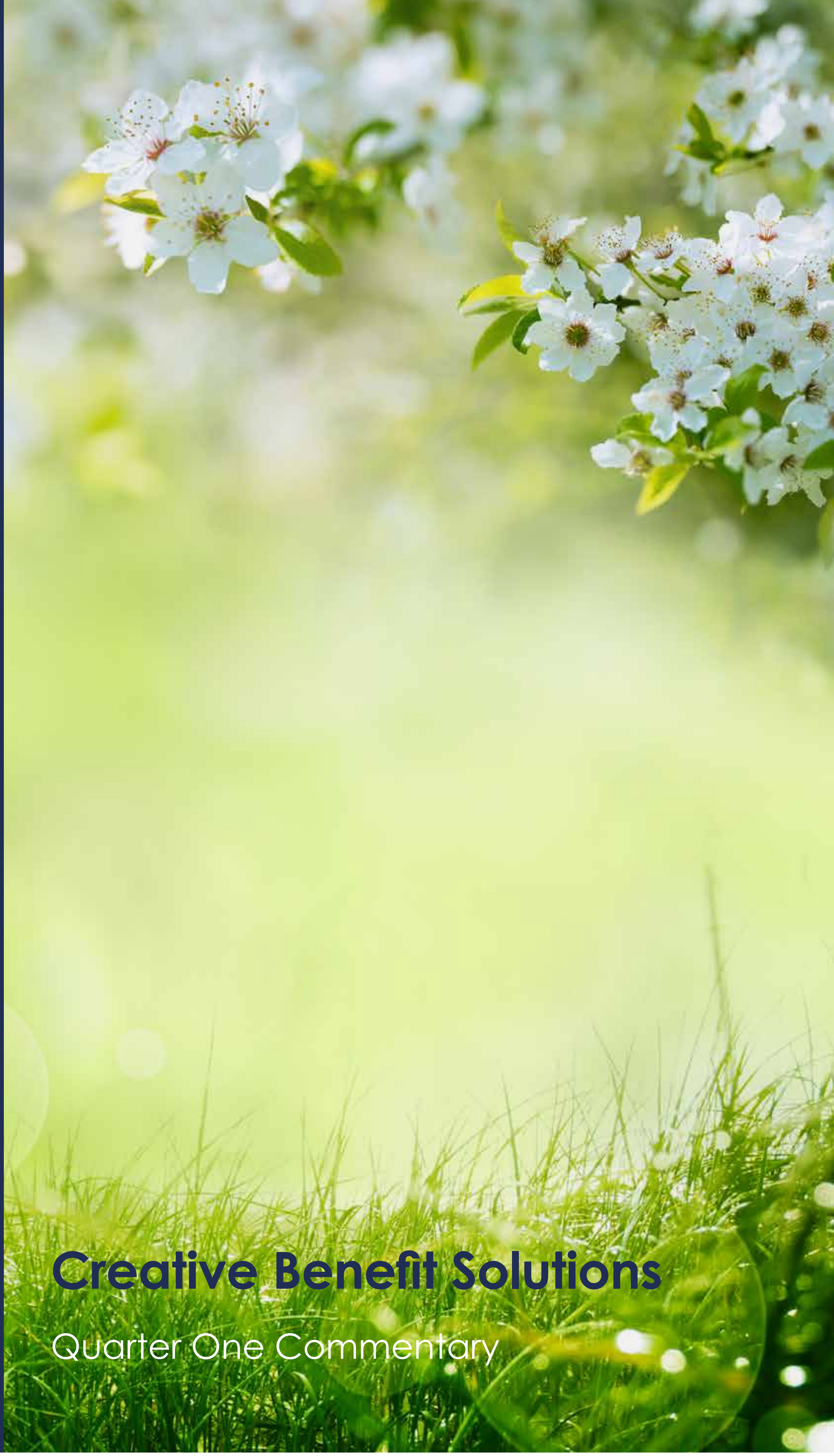
Investments



Creative Benefit Solutions

Quarter One Commentary

creative benefits

INTRODUCTION

We comment on 12 of the world's major stock markets in this Quarterly Report and the majority of them made an excellent start to the year. In January, 11 of them made gains – in some cases, spectacular gains which investors would have seen as a respectable return over 12 months, never mind one.

In January, there was good news on growth in China and the World Bank issued a bullish forecast as it looked ahead to 2018. Reporting that global economic growth had been stronger than expected in 2017, the Bank forecast growth of 3.1% for the coming year. The Bank's president, Jim Yong Kim, said, "The broad-based recovery in global growth is encouraging."

Add in the continued expansion in China, low interest rates and easy monetary policy around the world and it was no wonder that stock markets were doing well.

But February and March saw a completely different picture. Markets took fright in early February at signs of inflationary pressure in the US and there was a global sell-off. Many firms were passing Donald Trump's corporation tax cuts on to their employees in higher wages and there were fears of inflation leading to tighter monetary policy.

By March, the fears were of a trade war between the US and China: President Trump imposed tariffs on imports of steel and aluminium – making good on an election pledge but forcing the Chinese to retaliate with a raft of tariffs on American products. The US has recently published a list of 1,300 Chinese products it plans to hit with a 25% import tariff. Inevitably, China has "strongly condemned" the action and announced plans to retaliate.

The net result of all this is that only three of the markets we report on have made gains in the first quarter of 2018: the remaining markets are all down with, sadly, the UK leading the way.

Away from the stock markets, the first three months of the year saw Vladimir Putin and Xi Jinping consolidate their hold on power in Russia and China respectively, Angela Merkel finally find a way to cling on to power in Germany and the UK reach a 'transition deal' with the European Union. Let's take a look at the detail...

UNITED KINGDOM

The big business story in the UK in the first month of the year was the collapse of the government's 'go-to' contractor, Carillion. The company went under with debts of £1.5bn, including a hole in the pension fund of at least £600m, as Government ministers continued to dole out contracts even after three profit warnings. Up to 30,000 small businesses are owed money by Carillion and the receivers have told them to expect less than 1p in the pound on the money owed. There are bound to be redundancies and companies going out of business.

There was also continuing gloom for the retail sector as Toys R Us and Maplin closed their doors and Next complained of "the toughest trading conditions for 25 years". The Bargain Booze chain also admitted that it was "close to administration". The restaurant and hospitality trade has also been badly hit, with Prezzo the latest casualty, announcing the closure of 94 outlets and the loss of 1,000 jobs.

There was little cheer for the sector when Philip Hammond delivered his first Spring Statement: he did bring forward the review of business rates by a year, but that was it. There was relatively good news on the UK's debt and borrowing figures but, as previous Chancellor George Osborne frequently reminded us, the UK is always vulnerable to economic activity in the wider world, and any optimistic figures from the Chancellor could swiftly become irrelevant if the trade war between China and the US develops further.

The Chancellor did, however, give a pointer to what we might see in the Autumn Budget. The plastic tax had been widely trailed, as had yet more moves to tax multinational companies such as Google and Apple. Interestingly, he made a reference to 'seeking views' on encouraging businesses who want to use digital payments. The UK may have some way to go to match a virtually cashless society such as Sweden, but the Chancellor will be keen to encourage more digital payments: they can be tracked and taxed and would represent a way to strike back at the black economy.

One comment Philip Hammond did make was that people should be able to look forward to an increase in their real wages "by the end of the year" as inflation starts to fall. We may already be seeing signs of that with the latest figures showing a dip to 2.7%, thanks to a fall in petrol prices.

But if there was good news on inflation, there was bad news on the balance of payments. The deficit in the three months to January widened to £8.7bn as imports of fuel increased.

It also looks as though the Bank of England will have increased interest rates well before any of us see a rise in our real wages, with some commentators expecting an increase in base rates as early as next month. The Bank commented that rises might need to be "earlier" and "by a somewhat greater extent" than they had previously thought.

It was these worries about higher interest rates, combined with the threat of a trade war, which saw the FT-SE 100 index of leading shares fall by 8% in the first quarter of the year, the worst performance of all the markets covered in this report. The FTSE ended last year at 7,688 but has declined each month in 2018 and ended the quarter at 7,057.

There was better news for the pound, which rose 4% against the dollar in the first quarter of the year, ending March at $1.4017.

BREXIT

By the end of 2018, the UK will – in theory – be just 88 days away from leaving the EU. One way or another, progress in the negotiations has to be made.

That was what we wrote in the last Quarterly Report and – finally – it appears that some progress has been made, with
the UK and EU reaching an agreement over the 'transition deal' – the relationship and arrangement we will have with the EU after we leave, which is now less than a year away, on 29th March 2019.

Your view of the transition deal will very much depend on your initial stance on Brexit: but let us try and summarise the main points as impartially as possible:

- The transition period will end on New Year's Eve 2020 – three months earlier than had been predicted
- The UK will be able to negotiate, sign and ratify trade deals – for example with the USA – during the transition period
- Existing international agreements and EU trade deals will continue during the transition period
- The financial settlement we have already agreed is locked in, and both sides are committed to 'acting in good faith' during the period
- It is less good news for the UK's fishermen: the UK can only 'consult' on fishing during the transition period
- New EU citizens arriving in the UK during the transition period will have the same rights as those EU citizens already here
- And nothing has so far been agreed regarding the border between Northern Ireland and the Republic of Ireland.

It has been repeatedly said of the EU negotiations that 'nothing is agreed until everything is agreed' – but you have to think that the above will be the basis of our relationship with the EU for the 21 months after March next year.

Those in favour of Brexit generally see greater control of trade policy and the agreement to act in good faith as 'wins'. They are less keen on the extension of free movement and the fisheries policy. Those in favour of staying in the EU see it all as a mistake – but we are moving inexorably towards March 2019 and the UK will be leaving the EU.

A TURBULENT QUARTER FOR BITCOIN

We have written previously about Bitcoin, the virtual (or crypto) currency. The first quarter of the year saw it have a difficult time as both governments and central bankers weighed in against it. Bank of England Governor, Mark Carney, warned against “crypto-currency mania” and world leaders discussed a crackdown at the G20 summit in Buenos Aires, amid mounting concerns that Bitcoin is fuelling the black market, money laundering and other criminal activity. South Korea went further than merely discussing the problem, taking action in January to ban anonymous trading of the virtual currency.

Inevitably, all this depressed the price of Bitcoin. Having ended 2017 around $14,000 (£10,000) a coin, it declined steadily through the quarter – albeit with the occasional recovery – and ended March at just under $7,000, with some analysts estimating that up to $120bn (£85bn) had been wiped off the worldwide value of the currency in three months.

EUROPE

The year had begun with Germany still without a government, as Chancellor Angela Merkel saw her initial plans for a coalition fall apart. She was forced to go back to her old partners, the Social Democrats, as she finally put together a coalition which will allow her to remain as Chancellor for another four years.

This does, though, mean that the anti-immigration party Alternative fur Deutschland becomes the official opposition to the coalition. With anti-immigration sentiment already strong in EU member states like Poland, Slovakia, Hungary and the Czech Republic, there may well be increased tensions in the EU in the months ahead.

Staying in Germany, February started with thousands of metal and engineering workers in the south-west going on strike, essentially over their ‘work/life balance’. The strikers wanted the right to reduce their working week from 35 to 28 hours (on full pay) to allow them to care for children or elderly relatives, before returning to full-time work after two years. The concession was duly agreed by the employers and obviously could have implications for the whole of the German industrial sector. However, neither the political uncertainty nor the threat of strikes could stop Germany producing its inexorable trade surplus every month: €18.2bn in December and €17.4bn (£15.2bn) in January.

Political uncertainty was also high on the agenda in Italy, following the general election at the beginning of March. The Eurosceptic, populist Five Star Movement was the biggest single party with a third of the vote, but Matteo Salvini, leader of the anti-immigrant League, was also claiming the right to run the country as part of a right-wing coalition with former Prime Minister Silvio Berlusconi’s Forza Italia party. Inevitably, forming a coalition could take weeks of negotiation and horse-trading.

In France, President Emmanuel Macron will see his resolve tested in the coming months by a series of rail and airline strikes, as the transport unions begin a programme of concerted strikes in protest at Macron’s proposed reform agenda.

As you might expect, both the French and German stock markets were down in the first quarter of the year. The French index fell back 3% to end March at 5,167 but the German DAX index – much more vulnerable to a potential trade war – was down by 6% in the quarter. Having started the year at 12,918, it closed March at 12,097.

UNITED STATES

You cannot begin a review of the US anywhere other than the White House. January began with Donald Trump becoming the first President since Bill Clinton in 2000 to attend the World Economic Forum in Davos and ended with him delivering a bullish State of the Union address.

He seemed to have good reason to be optimistic: the economy was adding jobs, unemployment was steady at 4.1% and the stock market had gone through the psychologically-important 25,000 barrier.

The Federal Reserve Bank certainly seemed to share this optimistic view of the US economy: minutes from its meeting in February show that the Fed is preparing for "stronger-than-expected" economic growth this year as corporate America continues to benefit from the President's decision to slash corporation tax. Legendary investor Warren Buffet said that the move had given his company a $29bn (£20bn) profit boost.

February ended with good news for supporters of the President. Shortly after seeing his approval rating go above 50% for the first time in eight months, Donald Trump announced that he would be running for re-election in 2020, the news coming 980 days before Election Day.

There was further good news in March as the US economy added another 313,000 jobs, but the storm clouds started to gather as the President imposed import tariffs on steel and aluminium and – as we wrote in the introduction – there is now a very lengthy list of Chinese products which will face import tariffs. Reciprocal action from China is inevitable and it is beginning to look like some smaller countries may pay a high price for 'America first' if the trade war intensifies.

Facebook was also paying a high price in March. The company had $58bn (£41bn) wiped off its value after the Cambridge Analytica data breach scandal, leaving CEO and founder Mark Zuckerberg with a lot of apologising and explaining to do.

Inevitably, the Dow Jones index did not like the prospect of both a trade war and the continuing inflationary possibilities of higher wages. Having closed 2017 at 24,719 (and ended January at 26,149), Wall Street finished March at 24,103 – down 2% for the first quarter of the year.

FAR EAST

After the death of Mao Zedong in 1976, the Chinese Communist Party introduced a 'two-term limit', intended to ensure that a cult of personality could not re-emerge and that no one could 'rule for life'. But in March, the 'two sessions' – the annual meetings of the national legislature and the top political advisory body – did what had widely been expected and scrapped the rule, effectively opening the way for Xi Jinping to rule indefinitely.

One of the first appointments the new ruler-for-life would have rubber-stamped was that of US-educated economist Yi Gang as the next governor of China's central bank. It is an appointment seen as an attempt to ensure continuity, as China continues to try and rein in growing debt and risky financial practices.

The big question for China's new central banker is can the country maintain its remarkable growth rate and continue to be the economic powerhouse of the region? Figures for 2017 confirmed that the Chinese economy had grown by 6.9% - the first time in seven years that the pace of growth had picked up and ahead of the official target of 6.5%. Those who say, 'yes, the growth can continue' point to the fact that China only really became a key global economic power 15 years ago: that there is an ever-expanding middle class with ever-expanding consumer needs, and there are initiatives like the One Belt, One Road project.

Those who disagree, argue that China's growth is not real – that several provincial governments have already admitted to faking figures to meet targets. They also argue that growth must slow down as China's economy matures and that it cannot be based on the current high levels of debt forever.

For now, the world is worryingly dependent on China's continued expansion: for 2018, the growth target has been confirmed at 6.5% - which may prove difficult to achieve if a full-blown trade war with the US develops.

Away from growth targets, the end of March saw North Korean leader Kim Jong-un visit China – his first foreign trip since becoming leader. This was widely seen as a necessary precursor to Kim's meetings with South Korean leader Moon Jae-in and Donald Trump, and received a cautious welcome in South Korea, which obviously wants to see the end of nuclear weapons on the Korean peninsula.

In company news, South Korea's Samsung forecast record profits for the year of £10.4bn and unveiled its new S9 and S9+ phones to wide acclaim at the World Mobile Congress. In Hong Kong, banking giant HSBC reported record profits of $17.2bn (£12.2bn) – although analysts had been hoping for something closer to $20bn.

In Japan, the government responded to the problem of an ever-ageing population with a simple solution: it raised the retirement age to 70.

What of the region's stock markets? Hong Kong was the only market to make gains during the quarter. Having ended 2017 at 29,919, it moved up 1% to close March at 30,093. The other major markets in the region all fell, with South Korea down just 1% at 2,446; China falling 4% to 3,169 and Japan – which was especially badly hit by the US inflation worries at the beginning of February – down by 6%, to end the quarter at 21,454.

EMERGING MARKETS

Back in 2012, Vladimir Putin secured 64% of the vote as he won a six-year term as Russian President. In March, he gained 76% as he won another term which will take him to 2024, when he will be 72. Like Xi-Jinping in China, you feel that Putin will be President for as long as he wants to be.

Away from politics, the big story of the quarter was Canada's decision to join the Trans-Pacific Partnership (TPP) which Donald Trump so spectacularly pulled out of last year. Canada had initially been reluctant to sign up because of concerns about the environment and labour protection, but eventually signed the agreement alongside 10 other countries in March. The TPP has been championed by Japan, which sees it as a way to counter China's economic dominance in the region: Economy Minister Toshimitsu Motegi said the agreement would be an "engine to overcome protectionism."

On the stock markets, both Brazil and Russia made strong starts to the year, with the Brazilian index up 12% to end March at 85,366 and the Russian market up 8% to 2,271. However, having started the year at 34,056, the Indian market appeared much more vulnerable to worries about a trade war and closed the quarter down 3% at 32,969.

We will leave with that, and our Quarterly Report will be back in the first week of July. Please remember that nothing in this report should be taken as specific financial planning advice: it is for information only. Should you have any questions on any of the topics or comments above then, as always, please do not hesitate to get in touch: we are never more than a phone call or an email away.

CONCLUSION

We will leave with that, and our Quarterly Report will be back in the first week of July. Please remember that nothing in this report should be taken as specific financial planning advice: it is for information only.

Should you have any questions on any of the topics or comments above then, as always, please do not hesitate to get in touch: we are never more than a phone call or an email away.

Craig Harrison FPFS IMC
Chair of the Investment Committ