Economic

U.S. economy loses momentum precipitously, and the policymakers are slow to react

The U.S. economic expansion is into its 11th year. Naturally, most economies slow when approaching full employment. However, if a slow-down were exacerbated by a marked loss of confidence amongst households, the economy could slip into a more marked downturn. Given the pending Presidential election and the toxic atmosphere on Capitol Hill, a government response to a possible economic downturn could be slow.

European Central Banks and governments fail to provide support for fiscal expansion in the eurozone

European growth slumps without support from policymakers and asset markets sell off

Brexit trade talks go badly, and the U.K. leaves without a trade deal

U.K. sterling and equities fall sharply

Surprise shadow banking industry collapse

To some extent already seen in China and India but the problems could still deepen and cause problems for their respective governments.

The rise of inflation?

Never write off inflation. It is well known that the U.S. Federal Reserve is in the throes of trying to create more inflation. Recent employment reports showed the U.S. labour market pushing further into full employment as the unemployment rate fell to a historic low of 3.5%.

While we have our doubts that persistent inflation will take hold, the global economy is extremely vulnerable to a spike in inflation. Record high levels of debt mean that the global economy would take a significant hit from higher interest rates with the consequent impact of raising debt servicing cases.

Investors should be vigilant for any signs that the new sources of inflation risk don't rear their ugly head namely -

1. Trade wars that increase prices of goods and services.

2. The marked increase in global focus on Environmental Governance and Social (ESG) issues may have an inflationary impact. Saving the planet will cost money. Switching from to clean energy comes at a cost. Sourcing from more ethical/better governed/more social supplies will add to cost – while undeniably saving the planet in some small way.

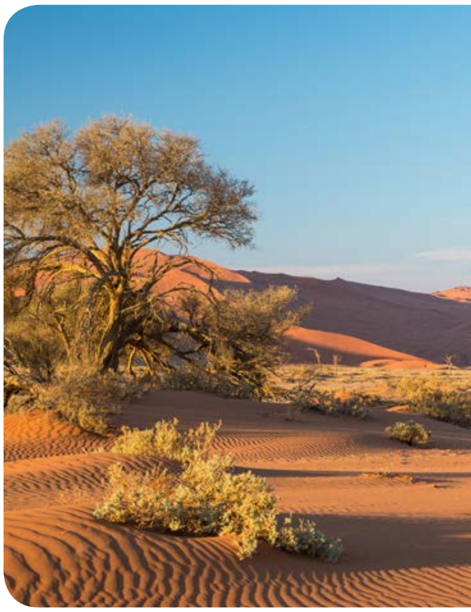
3. There is a clear risk that mainstream policies will become more left of centre. Populist governments typically redistribute wealth in favour of those on low incomes. Such a shift would put money in the pockets of the less well-off potentially unleashing a sharp increase in inflationary consumer spending.

4. The adoption of the relatively new Modern Monetary Theory (MMT) risks seeing central banks fund inflated government spending. MMT advocates central banks funding governments as they push their economies to full employment. But if only economic policy was that easy or that precise. The higher risk is that central banks are politicised to support the policies of 'populist' political leaders.

The world has never been so vulnerable to higher inflation. The IMF calculates that global debt to GDP was 225% at the end of 2017. In 1974 when there was the last burst of uncontrolled inflation debt to GDP was 110%.

Inflation strategy – reduce allocation to conventional bonds buy gold and indexed linked bonds.

Climate change



- A localised disaster that sets the world into a panic about the potential devastation from climate change.
- At least 21 cities in India, including capital New Delhi, Bengaluru, Chennai and Hyderabad, will run out of groundwater by 2020, affecting around 100 million people (NITI Ayog)
- Bangladesh called a "planetary disaster" (November 2019) mindful of the risks in the Ganges delta – in the 1970 500,000 people lost their lives on the Ganges Delta when Bhola cyclone created a surge of 25-35ft through the delta. Today 400m people live in the Ganges Delta.

A belated acceleration in action to arrest climate change including potential drastic change in taxes, substantial increase in spending on mitigation to climate change.

Geopolitical

U.S. elections

- The country gets distracted by political fighting with the risk of policy paralysis. It may stop effective economy management as Capitol Hill fights about matters such as impeachment and not managing the economy
- If President Trump gets re-elected the markets will be concerned about another four years of challenging global geopolitics.

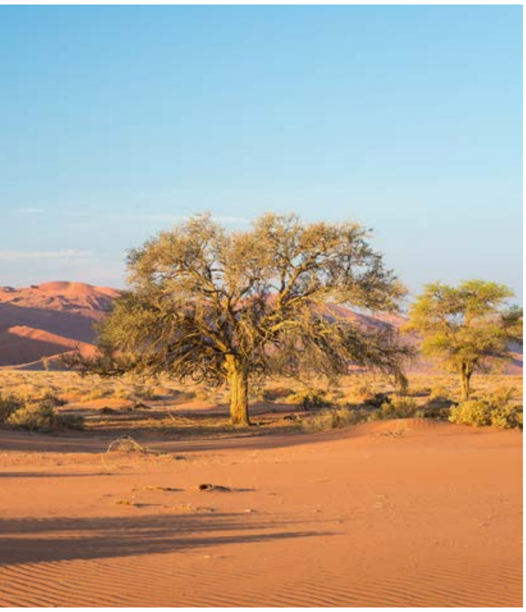
Conventional wisdom is that in the year of a Presidential election U.S. equities do well. Since 1928, out of 23 election years, only four saw negative returns from the stock market. However, we all know how unique Mr Trump is!

Elections in Central and Eastern Europe

- Polish presidential elections, Romanian parliamentary elections and Slovak parliamentary elections may heighten tensions with the E.U. around areas such as the politicisation of the judiciary, environmental and migrant policy.

Trade tensions escalate

- President Trump is under pressure due to the pending election may lash out on trade policy to re-establish his credentials around the "Make the United States Great Again" campaign.
- The trade war between South Korea and Japan continues to simmer. Any further escalation could damage regional growth.



Markets

Flash crash in financial markets

- The very sharp fall in the equity market in the fourth quarter of 2018 underscored the vulnerability of the equity market to a flash crash
- We remain concerned that retail investors, despite some selling through 2019, remain overweight in equities. Yet, many cannot afford to see a significant drop in their wealth ahead of retirement.
- Enough commentators are warning about the potential lack of liquidity in bond markets for us to write off the risks as doom-mongering. The structural changes in the markets post the world financial crisis leaves little capital committed to ensuring continuous dealing through a crisis.

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