

Be brave and remember we are all in it for the long-term

2019 will be a tumultuous year.

There are several power plays that we think are going to evolve during the year and they can be summarised as follows.

- Fiscal stimulus, or a lack of it and a reduction in money supply, combined with an increase in interest rates, albeit they are marginal.
- Trump and his view of the world, which is to run the world a bit like a business and push as far as you can without worrying too much about the collateral damage on the way through his agenda.
- Xi Jinping and continued authoritarian central control of the Chinese economy.
- Significant issues in Russia, particularly around the whole issue of Putin's control as he becomes less popular and is being overtaken by the Chinese as either the second or possibly the most significant global power.

We must not forget that driving all the above agendas is still the central themes that nobody can get away from and that is:

- a) An ageing population.
- b) A falling birth rate in many developed economies of the world.
- c) The possibility that the population of the world will peak earlier than anticipated.
- d) The unbelievable speed at which technology and the subliminal adoption thereof by so much of humanity is reshaping the whole way in which we think about the world.

2019 will be an extremely difficult year; indeed, the next ten years we believe may prove to be exceptionally challenging for the world in all the ways in which we describe above.

Trump

The fundamental agenda for Trump is to run the world like a business and hope that he can push and shove, bully and cajole his agenda onto the world stage as efficiently and as effectively as possible.

He has absolutely no qualms about being dishonest, changing his mind and manipulating information in whatever way he thinks may help his agenda. This is upsetting the world order, it makes planning incredibly difficult and, as was commented on the radio over Christmas into the New Year, he runs the world by his gut instinct rather than what his brain is telling him (that's assuming that we give him credit for any brain!)

Xi Jinping

The premier of China is increasingly running China as an authoritarian state.

There is continued centralisation of power and control. This has benefits and disadvantages. Clearly, it isn't good for the freedom of press, for dissidents and for the future evolution of a liberal, balanced economy. However, it is good in trying to plan the future in the very short-term as it is most likely that Xi Jinping will try to manage the Chinese economy in a positive direction such that it does not threaten or damage his position.

Whilst the Chinese continue to improve in affluence, wealth and success, so he remains relatively secure in his position and therefore it is quite likely that China will come to the rescue of the global economy as and when and if required in order to retain Xi Jinping's power base and his administration.

Putin and Russia

Russia is going to have to get used to the fact that it is no longer the central alternative power base in the world. Indeed, it may well wane in its ability to manipulate global events as China overtakes Russia

and America finds other ways of manipulating the system. It must be extremely frustrating for Putin to find that he is dealing with such a completely irrational human being in the White House. A person that does not conform to his way of structured thinking that he would have been used to in dealing with through all his KGB days and the way in which he has managed to outfox the liberal community in Europe and America for the last few decades.

Europe and BREXIT

Neither side wants a breakup of the European Union in a bad way but for now, that looks increasingly possible as far as the markets are concerned.

Europe has become known as a global rule-setter and however frustrating some of the rules may be in Europe, they set various standards – some of which are very good such as climate change and some of which are very bad such as the daft regulations that come out of Brussels around frustrating bureaucracy.

There is the possibility that the euro could implode under the enormous budgetary pressures that are placed upon it, especially by countries such as Italy and Spain who (incidentally, have temporarily settled their budget arrangements with the European Commission). The reality remains that the enormous surplus in Germany, opposed to the enormous deficit in the rest of Europe, will continue to put enormous pressure on the whole European experiment and in particular the euro.

With Far-Right parties arriving all over in Europe (the latest being in Spain over the Christmas period in winning various regional elections) we must assume that one of the central issues is as follows.

Far-Right political parties

As with 100 years' ago, these parties arrive when populations become deeply frustrated and the frustration comes from ill-information, poor communication and a lack of up-to-date education to keep people up to speed with the dramatic evolution and change in life.

Revolutions appear in many different forms – be it the Bolshevik Revolution in 1917 or the Chinese Revolution in 1949, let alone Hitler's rise to power, Franco in Spain or Mussolini in Italy, they all had one overriding similarity which is a deep frustration with the political system and a feeling that ordinary people were simply being abandoned and not listened to by the establishment – whoever the establishment may be.

Protectionist, Far Right politics has an ability to attract a huge amount of frustrated people, not because they necessarily believe in the rhetoric, but simply because they are prepared to vote to give somebody a bloody nose. As a simple example, I would argue that many people who voted BREXIT didn't do so because they were anti-immigration, or because they believed any of the ridiculous claims made by both sides in the campaign, they voted simply because they felt that Europe had left them behind and that they had no feeling of democratic input, control or influence over such an enormously large and diverse organisation.

Politicians and central bankers

The central theme, we believe, that is going to run through 2019 will be the power broking and balance between central bankers and politicians.

I continue to observe that in my opinion, the central bankers of the world which number about 8-10 people, have finally had enough of being the whipping boys of politicians who refuse to step up to the plate and take responsibility. Of course, what we have seen and a good example of a politician trying to persuade the population to live within its means is in the form of Macron's attempt to change the French economy with a fairly disastrous run up to Christmas as a consequence.

We do not think that central bankers are suddenly going to reduce interest rates again or to start printing large amounts of money. We suggest that central bankers will be telling prime ministers, presidents and even autocrats that the time has come for politicians to find other ways of stimulating the economy be it by:

- a) higher taxation
- b) lower public spending
- c) relaxation in regulation and red tape
- d) accepting that the global economy is going to slow down and even possibly shrink in monetary terms as we get used to an alternative type of economy which is not based upon wealth and stuff, or money and power.

Alternatively, it is going to be based upon intellectual capability, digital adoption and technological advance.

European elections in May

Not only is all the existing hierarchy of Europe changing during this year so that Britain may well be negotiating with a totally different set of actors in Brussels in 12 months' time.

European elections take place in May 2019, all the indicators suggest a very different mix of EU MPs and a much more robust and influential parliament than we have ever seen before.

If I were Theresa May, I might bet on a very different animal to negotiate with by the year-end and so she may well frustrate any conclusion to BREXIT until then. Whatever happens, it is going to be enormously difficult to predict the future.

What is KMG going to do about it?

Many of you know that we have offered the opportunity of moving into cash and this is an entirely acceptable option for anybody to pursue. If you simply do not want to take any sort of risk and you are happy to hold money in cash which is traditionally thought of as a risk-free option, then we can move some or all of your portfolio. Indeed, we can move it into sterling, dollars or euros and you can also have a balance of these currencies.

The dilemma is to know which cash is likely to be the most profitable to hold. We have seen a dramatic reduction in sterling's value across the world as a consequence of BREXIT, the dollar is very volatile as a consequence of the trade wars that Trump is playing. The euro is under huge pressure because of its banking system and budgetary issues.

If you hold cash, you cannot expect any real interest rate return. You must accept the vagaries of monetary policy and devaluation as a consequence of different factors affecting the world. You of course would also lose out on any market bounce.

Should we invest in gold? The answer to that question is simply to look at how the gold price has fared over the last ten years and indeed over the last 12 months to realise that the gold value does not seem to bear any logic to volatility or risk and again, remember that gold does not generate any form of dividend yield.

The reason that KMG's strategies will remain in place and we will continue to recommend that you remain fully invested in the market is for the following, sound reasons:

- 1) We do have a wide range of currencies within the investments that we have made across the world.
- 2) We have a wide range of investments in almost all the continents and countries of the world in various shapes, forms and sizes.
- 3) We have a broad range of companies that we invest in.

- 4) We try to pick assets which particularly reflect our thoughts about the future which are:
- a. the evolution of artificial intelligence
 - b. the rise of robotics
 - c. the inclusion of more specific medicines and pharmaceuticals
 - d. a change in eating habits and dietary habits
 - e. climate change and all that that relates to including a change in purchasing habits around plastics together with a reduction in the consumption of meat which may reduce global warming
 - f. a mix of energy products and a concentrated examination into alternative energy sources which we think will become inevitable as climate change becomes more and more important and the weather patterns of the world become more and more volatile and extreme

Investment cycles

Without over stating the obvious please remember the following:

- all investments (as with fashion and consumption) go in cycles
- the fixed interest markets have seen 20-30 years of steadily rising values on the back of steadily falling yields and interest rates, and this cycle has basically come to an end
- property tends to go in ten to twenty-year cycles, as discussed below.

The challenge is to move to the next cycle rather than try to hang on to the old cycle in the hope that somehow the past can be sustained. It will not be, and it never has been possible. Those that lose the most are those that refuse to adapt and/or be brave enough to withstand significant and ongoing change.

Bonds or fixed interest investments versus equity

Just to remind you fixed interest or bond investments require interest to be paid and good quality assets are paying very low rates of interest. If fixed interest investments go bad, they can and do disappear. They also get devalued by inflation, sterling's weakness, and company default (as we have seen recently in many examples).

Equities do go down, yes, they can go bust, and they are volatile but every scrap of evidence from history shows the following:

- dividends tend to be paid, so there remains an income source whatever the value of the share price
- they do keep pace with inflation
- they reflect any local currency weakness (going up when sterling goes down etc)
- collectively they always, in the end, eventually rise
- and, believe it or not, over time, outperform all other asset classes, even property.

Property

Many of you remember the artificial boom created by Nigel Lawson in the late 80s with double Miras tax relief which came to an end just as we went into a down turn. It took ten years for prices to recover and move ahead.

Such a period is likely now, for many different reasons, but in my working lifetime I have seen two negative property cycles, and this is probably the third.

Negative property values have great influence in the wider economy in behaviour and thus it can create an unfortunate catalyst for a long period of low growth, poor spending and consumption habits which of course feed on each other, creating a downward spiral.

KMG's investment strategy will not be a perfect solution but it does try to meet as many of the challenges as we see into the future and at the same time, it does attempt to provide the least-worst investment spread in what is going to be an extremely challenging investment environment over the next 12 months.

As most KMG clients will have experienced over the last 20, 30, 40, 50 or 60 years, we have been through these periods many, many times before. We have had negative investment periods of one to three years and we have survived. We have constantly reappraised our strategy in order to achieve the best possible result in challenging times. We will continue to follow our instincts as best we can, but we are always welcome to be challenged by you and to consider other investment opportunities as and when and if they arise.

Please do not hesitate to call and discuss this bulletin and your affairs in general. We hope to make sense of a very confused world and a very erratic set of politicians who are least capable of managing the global economy.

Patrick McIntosh
January 2019

