

Schroders Investment Conference – June 2017

We recently attended an investment conference hosted by Schroders. The conference covered an overview of the markets and specific views from regional managers. The views contained in this note are those of Schroders and do not necessarily reflect our own views.

Market Themes – Phil Middleton

The conference started with Phil Middleton providing an overview of the markets. He started by discussing the hot topics – will Trump be impeached, will there be a BREXIT deal and where will the FTSE be by the end of the year.

Turning to politics he explained that it is an interesting time both in the UK and Europe. At the time of the conference the election hadn't happened but he felt the result was difficult to call. He believed the youth vote would be really important in this election. He also felt the markets wouldn't react well to a Labour victory.

In terms of BREXIT this would depend on the make-up of the government, but the view was that there would be no deal with a transition period and actually this wouldn't be bad for the markets.

In terms of inflation in the UK, the big concern is that household consumption was a big driver for the economy but with rising inflation this could slow things down.

With mainland Europe, the main election is in Germany but they don't expect any surprises. There could be an election in Italy this year, but generally following results in France and Holland political risks seem to have dissipated. The focus is then on the fundamentals. His belief is that actually things are looking okay; corporate fundamentals look good with limited defaults on bonds, corporate growth is fairly strong and inflation is pretty much under control. If there is a risk then it is with Germany, where there are challenges surrounding wage inflation.

Turning to global growth, they think this will be around 2.9% in 2017 and will continue to be strong in 2018. They believe that Trump has helped in terms of confidence but nothing has come through in hard data. In other areas, they believe there are still opportunities in emerging markets, and Asia which in particular remains cheap.

UK – Alex Breese

Alex explained that negativity and uncertainty tends to be good for markets.

In terms of the election, his thoughts were that even though we have had three elections in seven years plus, the EU referendum, the FTSE is on all-time high. He explained it was difficult to forecast the outcome of one political event (just consider Trump, Brexit etc); even if you had guessed the right outcome, would you have made the right trade?

If we consider Brexit, all forecasts were wrong. The weakness in sterling helped the FTSE 100 because many companies have foreign earnings. He thinks sterling might strengthen to the medium but it will remain volatile. He believes winners could be retailers and transport, with losers in software, resources and consumer staples.

Brexit is a greater concern as weaker sterling has impacted inflation; there is a lot of uncertainty as to what deal we will get, which can destabilise the economy but the view is that this is already priced into the markets.

In general terms, he believes the UK is one of the cheaper markets, and even with the political uncertainty the backdrop is not too bad. If sterling weakens then this will impact mid and small cap companies but obviously the reverse if it gets stronger.

Asia – Matthew Dobbs

Matthew believes there are lots of great opportunities in Asia.

His view of China suggests he thinks growth has picked up, helped by the recent stimulus. There are areas to avoid like infrastructure stocks, and he admits there are concerns about debt but this is only high compared to other Asian economies and not developed markets. In the financial sector, they are moving towards a vulnerable phase in relation to deposits vs credit but at this stage he doesn't believe this is something we should be concerned about.

We should really focus on the astonishing pace of change across Asia; in China, electric cars are one of the biggest growth areas, and they are pushing to develop driverless cars. The top three biggest global spenders in terms of R&D are Korea, Taiwan and Japan. Demographics still play a massive part in the region with the young being some of the biggest earners.

Interestingly political risk shouldn't be a reason not to invest, in Korea they have political risks with China, missiles from North Korea, impeachment of the President, arrest of senior officials at Samsung and strikes by car workers and yet the stock market is at an all-time high.

Asian companies tend to be very cautious about capital spending, and therefore dividends are lower but with growth potential. One additional point made by Matthew was that much is made about trade wars with the US, but much of the market trades with other Asian states and Europe.

Europe – James Rutland

James started by saying they are very positive about Europe but you need to be in the right place.

Structural inflation is coming; for example, prices of tyres have increased by 10%. Although unemployment seems high, the labour market is tightening and wage inflation is creeping into Germany. Factories are starting to get pricing power based on orders, and interest rates look unlikely to rise within the next 3 years.

For Greece and its debt, they believe there must be some debt forgiveness, and the main political risk is Italy but this could be some way down the road.

Interestingly James explained that at the start of the year, Europe was very much seen as un-investable but once the French and Dutch elections were over that money started to come in. He believes bond proxy stocks and cyclicals are now expensive, and therefore there needs to be a rotation away from these.

He believes areas of value include financials, telecommunications, technology and pharmaceuticals. Much of the regulatory headwinds are fading for telecoms, prices are going up and costs are coming down.

So, for James Europe is a good place it's just about being active and selective.

Fixed Income – Adrienn Sarandi

The general view is that high yield is the place to be. Firstly, it has been a strong performer over the last ten years, secondly unless we are heading towards a recession it does pretty well, and thirdly high yield tends to be less sensitive to interest rates.

At the moment, they believe the macro picture is healthy; where there was talk of a recession it seems this has been skipped and the global outlook especially in Europe and US looks good. There is more uncertainty in the UK.

Adrienn argues that high yield needs active management not only to identify themes like investor trends, demographics, regulatory changes etc but also the ability to identify the right opportunities.

There are lots of examples of good opportunities, such as Iceland Food, Gazprom and YPF but you need to be prepared to buy on the way down and wait for the uplift.

So, similar to the other managers, fixed income needs active management and the ability to identify good debt which offers the best risk adjusted returns.