BlackRock Investment Conference – June 2017

We recently attended an investment conference hosted by BlackRock. The conference covered an overview of the markets and then specific views from managers and their regions/sectors. The views contained in this note are the views of BlackRock and do not necessarily reflect our own views.

Market Themes

The conference started by looking at investor trends; investor confidence is coming down (currently on 39% from 49% last year) and 69% of investor assets are held in cash. With the last point, worryingly 73% of investors think inflation will rise making cash a greater loss making asset class.

The main areas of concern are the push for inflation, low returns and political risk. Inflation has started to pick up and we have seen improvements in US growth which is reflected in the performance of risk assets. We should expect a period of sustained growth, and a rotation away from surging growth models.

Within the G7, US has dropped to last with Canada leading the pack followed by Germany, UK, Japan, Italy and France.

The general view of where the market is heading is that this has been a very flat cycle, and therefore recovery has been slow. Their view is that we are about half way through the cycle so there is still some way to go.

They see China as a risk with PMI (manufacturing index) coming down, but they don't see a hard landing and economic growth hovering around 6 to 6.5%. They also feel that the build-up of credit shouldn't be ignored.

Inflation is ever-present, with the US bouncing at around 2%, but they are not seeing wage inflation; they think Europe and Japan will have lower targets and the UK might surprise (but don't think this will make any change to interest rate policies).

There is political risk as we have seen in the UK but also with Germany and Italy, as well squabbles in the Middle East with Qatar. But there are good drivers globally for earnings growth, with revisions at all-time highs. At the moment, they feel non-US equities will do better.

Turning to bonds, they think gilts are expensive but they like emerging market debt (hard currency) and UK Investment Grade (especially financials). They see value in equities across most sectors but especially UK, Europe, Emerging Markets and Asia.

Asia

They believe Asia is in a bull market at the moment; after a protracted negative period, we are now 18 months into a recovery cycle.

Interestingly Asia is underused in many portfolios; it accounts for 25% of global GDP but is only 7.5% of the global index. This means many investors are missing out on great opportunities. A normalisation of G7 economies is good for Asia, and many companies are disciplined with earnings, which enables them to expand margins.

There are risks around reforms which might go wrong, US interest rate rises could have a negative impact on emerging markets but if there is a gentle rise it shouldn't happen, and any strengthening in the US dollar could be negative for the asset class but again this is not a concern at the moment.

In terms of economies, India is interesting especially relating to reforms; the most talked of which was demonetisation and the impact on the black market. Other economies they like are China and Thailand, although they may replace Thailand with Japan. Economies they don't like include Hong Kong, Taiwan, Singapore and Malaysia.

UK

There have been 9 Conservative governments, and 8 Labour governments. 12 months after these elections, the average returns when Conservatives are in power are 9% and 23% for Labour. So, change is not always a bad thing.

The PMI data is the fastest growing in the developed world following the collapse in sterling, growth remains healthy and although consumer confidence has dropped, the UK remains a strong economy.

Valuations are average in the UK, but there is a massive amount of foreign investment which is positive. UK companies are strong dividend payers and companies they like are Lloyds, Rentokil, Unilever, Next and Relx, the latter being a good example of companies that have embraced technology. There will always be concerns around the pace of automation and the impact that will have on jobs but companies do adapt.

So, the view is that irrespective of the new government, the UK is doing well so far, but obviously there is a cloud of uncertainty around Brexit.

Fixed Income

The yields on UK and US government bonds have diverged. At one point, they were close when it seemed we would be following the same path. They feel the market has confused reflation and Trump-flation. Reflation is in oil prices, US earnings etc, whereas Trump-flation is things like tax cuts and deregulation.

The UK and US are now moving in different directions. In the medium-term, things will slow in the UK because although people are investing today they are not forward planning, because they don't know what lies ahead. Inflation in the UK has been driven by sterling, but wage growth inflation has stagnated.

They have a preference for sterling assets as they think there are more opportunities than in Europe and the US.

Natural Resources

They believe we are in the early stages of a natural resources recovery cycle.

They think it offers good diversification. The three main areas are energy, mining and agriculture.

They see an improvement in global macro markets as a benefit to emerging markets.

Across these sectors there are low valuations. They think many people underestimate oil prices and although they don't think they will go to $100 a barrel, they think prices will go up significantly especially with the problems in Qatar. In mining, cash flows are strong with double digit growth returns expected. Turning to agriculture they believe crop prices are at an all-time low, so there is downside protection but a lot of upside.

So, as a summary they believe this is a cheap sector which is a good diversifier within portfolios.

Europe

With Brexit they think there will be a lot of noise but at the same time a lot of diplomacy in the background.

In France Macron could get a majority government which would be amazing for a new party; but he added much of the upside from France is already priced in.

In terms of political risk, they expect Merkel to win the German elections and the Italian election will now be in 2018.

The macro picture of economies looks pretty good, and many companies have global earings and this makes a big difference. Although money hasn't really come into Europe due to concerns about the Dutch and French elections, investors from Asia are looking to invest.