LGT Vestra Snapshot

07 November 2018

After a very turbulent year, almost all asset classes have produced a negative return except for US dollar cash. There are three main theories for what the last few weeks of market moves tell us about the current investment environment and the three different theories each have different investment outcomes.

The first theory is that we are experiencing a liquidity squeeze caused by a combination of quantitative tightening in the US, a higher oil price and a strong dollar. What we have seen thus far in Turkey and Argentina are proof of the rising cost of capital faced by these nations who are burdened with dollar debt. The world is looking towards the US to either pause their tightening or for more China stimulus (or hoping for oil or the dollar to weaken). If this ends up being the case and the US stops raising rates, this should be positive for Emerging Markets equities and debt. However, if the US continues to raise rates, this could result in more pain for Emerging Market equities. If we are in a liquidity squeeze and it continues, the small fish that have floated to the surface thus far (Turkey and Argentina) may lead to a much bigger whale such as a big bank in Italy or Spain. If such a whale floats to the surface, this could be the catalyst for the Fed to change tack.

The second theory is that “winter is coming” and the last few years of global synchronous economic growth are over; 2017 and early 2018 were as good as it gets for this cycle. Many of the leading indicators such as PMIs, the OECD leading indicator, US house prices and US auto sales have begun to roll over. Since 1st August 2018, we have seen a big outperformance in defensive sectors such as utilities versus cyclical stocks, for instance: banks. If we have reached the end of the cycle, one should buy long dated US Treasuries (30Y).

The final theory is that we are experiencing a paradigm shift caused by increasing geo-political tensions and the end of the "Chimerica" relationship. The rules-based order that we have come to know has come to an end, as has the globalisation that helped deliver a deflationary boom for the last 30 years. This could be inflationary as tariffs and sanctions lead to cost push inflation. In this instance one should own US equities, dollar cash and gold. Bonds and equities would lose their negative correlation as we have just seen in the sell-off and this would change the way in which asset allocation is managed. Another view is that there will be a deal which could lead to a rebound in equities and another leg on in the bull market.

At LGT Vestra our view is that we are not yet at the end of the cycle, rather at the mature end and such narrow market leadership from the FAANGS is indicative of this. For this reason, over the course of the year the MPS and Volare team have increased our allocation to active managers (MS US Advantage over Vanguard US Index Tracker), managers who can profit from stock dispersion and volatility (Artemis US Absolute Return) and have increased our allocation to cash (Balanced portfolio).