Investment Insight

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ARIA | CAPITAL

Clash of cultures: *Ultimately cultural, rather than economic or political, differences between our Anglo-Saxon neighbours and other EU states may be at the root of the UK's move for Euro independence, a.k.a. Brexit. Whether it stems from an imperial heritage, monarchical self-confidence or a conviction that none can surpass their fish & chips, there is little doubting that the British think differently to their Continental cousins.*

*At a recent investment conference in Berlin at which there was a large UK attendance, Peer Steinbrück, Federal Minister of Finance Angela Merkel's first cabinet, was a key speaker. He appealed to the UK attendees to use whatever powers of persuasion they might have in political circles to convey to political leaders that they have entirely misunderstood the European negotiating mentality in their approach to Brexit negotiations, with potentially dire consequences for the UK. In this week's **Inside Track** we elaborate on the matter.*

CAPE fear? *From time to time the "Shiller PE" or "Cyclically Adjusted Price Earnings" ratio comes into greater focus. It not uncommonly enters the valuation debate at times when more conventional, some might argue simplistic, price-earnings ratios appear to be either unsustainably low or unsustainably high. The CAPE is based on average inflation-adjusted earnings from the previous 10 years; as such, it should smooth out the sometimes distorting impact of shorter term earnings cycles. But what message is the CAPE sending currently – fear or hope? In this week's **Pic of the Week** we take a look.*

Quoted...

"A lot of what happens in markets is driven by pure stupidity" – Robert J Shiller

The Inside Track

"They just don't get it" was the gist of what former German Federal Minister of Finance Peer Steinbrück said about British Brexit negotiators last week.

Peer Steinbrück probably wouldn't be everybody's idea of good company. Coming across as somewhat prickly and dogmatic, he volunteers strong views on political matters and, one suspects, mightn't take kindly to those with the temerity to contradict him. But leaving personality aside, there is no doubting that he has vast political experience at a German and European level and he has the connections to have the inside track on Brexit negotiations.

Speaking at an investment conference in Berlin last week, he gave a continental European perspective on Brexit. Two things became clear:

1) The rest of the EU, with the possible exception of Ireland, cares a lot less about the UK's departure from the EU than UK politicians, media or public think they do. There is no doubting that the rest of the EU would much prefer the UK to "see sense" and reverse their "irrational" decision; however, assuming that they won't do so, the UK should know that they have far fewer bargaining chips than they might think. Ultimately, if there is a "no deal" outcome to negotiations, the EU's attitude will be relatively benign, but the cost to the UK could be severe.

2) The UK negotiators have completely misunderstood the continental negotiating mentality. To paraphrase heavily, Mr Steinbrück characterised the UK approach as "throw the ball in and see what happens, see who will blink first". The continental Europeans don't play that game. They decide what the outcome should be in considerable detail and then they work methodically backwards to plan the steps required to reach that outcome. They simply "don't get" the UK approach which, to their eyes, starts with no plan.

For these reasons, absent a major shift in the UK approach there is a very significant possibility of the UK leaving the EU with no exit deal being agreed. This won't be a fantastic outcome for Ireland, but it could have much more severe implications for the UK which could find itself politically, economically and culturally isolated from all of its surrounding neighbours.

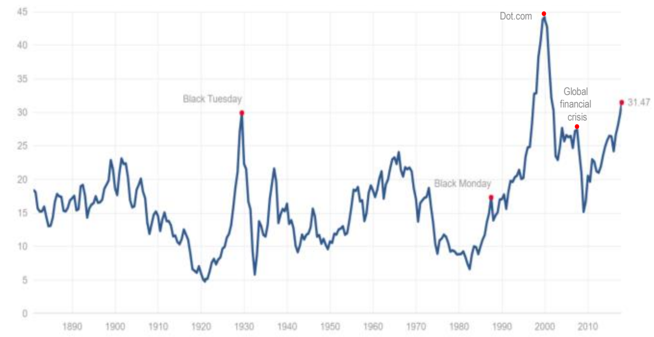
Meanwhile, politics and economics are starting to collide. Following a shot in the arm from a significant currency devaluation in 2016, the UK's economic data has recently taken on a decided pallor. In contrast to the rest of the EU, which has shown a strong pickup in retail sales to 3.7% year on year, UK consumers have been experiencing a squeeze on real incomes as inflation remains above wage growth. This has weighed on spending and has led to a softening in retail sales to just 1.2% year on year, a long way from the 7.3% peak observed in 2016. Whether a dawning recognition of their economic predicament will lead to a change in the UK's political negotiating stance, only time will tell. Let's hope so.

Pic of the Week

The CAPE (or "Schiller PE") has been measured back as far as about 1880. Shiller argues that each of the first four run-ups coincided with the emergence of a "new era theory" in the popular culture that extolled the virtues of new technologies. The resulting investor enthusiasm fuelled a "this time is different" mentality in which traditional valuation metrics were ignored, causing stocks to become overvalued relative to earnings. The average CAPE of the S&P500 over the last almost 130 years is 16.8. Today's value is 31.47. It has only ever been higher once and that was in the run up to the dot.com crash. There is an extensive body of academic research on the matter, which space does not permit us to expand on here (contact us if you would like to know more!). However, suffice it to say, that on a CAPE basis, the US market isn't cheap.

Market View

	Last 7 days	Last 12 mths	YTD	5Y Ann.
Global equities	-1.3%	+18.1%	+13.8%	+11.1%
US equities	+0.1%	+18.9%	+15.6%	+13.7%
European equities	-2.1%	+12.6%	+5.3%	+7.3%
EM equities	-2.0%	+31.2%	+28.9%	+2.8%
Irish equities	-1.2%	+10.7%	+4.9%	+16.6%
Commodities	-1.9%	+4.5%	-2.0%	-9.5%
Hedge funds	-0.4%	+6.0%	+4.4%	+2.2%



Week ahead: Key events

20/11 US Leading Indicators
21/11 US & Japan Retail Sales
21/11 US Existing Home Sales
22/11 US Mortgage Applications & Eurozone Consumer Confidence
23/11 Eurozone PMI Data
24/11 UK Mortgage Lending & US Manufacturing PMI Data

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+0.6%	+0.6%	+5.8%
Germany	+0.4%	+1.6%	+2.8%
USA	+2.4%	+2.0%	+2.3%
China	+3.9%	+1.9%	+6.8%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.18	+12.0%
EUR:GBP	0.89	+4.6%
EUR:CNY	7.80	+6.3%
GBP:USD	1.32	+6.9%
Bitcoin	7,686.51	+707.4%

Commodities	*Current*	*YTD Δ*
Gold	1,280.84	+11.2%
Copper	6,736.25	+22.0%
Oil	61.48	+4.8%
Wheat	439.50	-8.0%

Central Bank rates	*Current*
Eurozone	0.00%
USA	1.25%
UK	0.50%

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