Investment Insight

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ARIA | CAPITAL

The Long Depression: *History doesn't necessarily provide a guide to the future, but that doesn't mean we can't learn from it. But which historical learnings might be of use in analysing current markets? According to the highly regarded fund manager Terry Smith, the "Long Depression" of 1873 to 1896 may be a worthy parallel to the post Global Financial Crisis era that we are currently in. This was a period when a new industrial power (post-civil war America on that occasion) came on stream and caused a wave of deflation through its ability to manufacture goods more cheaply than previously. The Long Depression was also preceded by a collapse of part of the banking system. Sound familiar? In this week's* ***Inside Track*** *we explore the parallel a bit further.*

Great expectations: *With the US economy showing encouraging economic signs, many of the Fed's long-term economic targets have been reached. Interest rates are widely expected to be increased as a result, but by how much and when? In* ***Pic of the Week*** *we take a look.*

Quoted...

"You can observe a lot by watching."

– Yogi Berra

The Inside Track

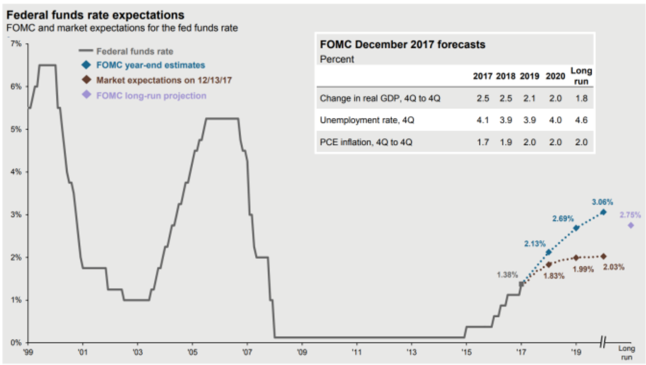
Terry Smith, the highly regarded CEO and portfolio manager of Fundsmith, sees parallels between the "Long Depression" and today's post-GFC era. These are some of his observations.

The wave of deflation we have been experiencing has been caused by a number of factors. These include the rise of China as the world's greatest industrial power, other cheap manufacturers (South Korea, Thailand, Vietnam, India and Malaysia for example) and the offshoring of manufacturing to cheap manufacturers under free trade agreements, such as Mexico under NAFTA, which so exorcises President Trump. The situation now is probably worse than it was during the Long Depression insofar as then there was virtually no international competition in services whereas now in our connected world there is in software (India) and call centres (the Philippines), for example. Plus there is the rise of the so-called gig economy in which the internet, casual employment and the sharing of assets have made price comparisons easier, and have driven down prices and returns in retail (Amazon), transport (Uber) and lodging (Airbnb), for example.

If the closest analogy for the events which we have experienced since the Financial Crisis is the Long Depression, we may be barely half way through it simply on the basis of elapsed time. In which case, the period of sluggish economic growth and low interest rates which we have experienced over the past decade may persist for some considerable time. I think this is likely for the simplest of reasons: little or nothing has been done to correct the problems which led to the Financial Crisis. The unsupportable expansion of credit that sparked the crisis has not been resolved. There is in fact more debt in existence now than there was in 2007. Admittedly, some of it is in different hands—China has more debt now and much of the debt in the developed world has been 'socialised' and assumed by governments. However, governments are just us collectively, contrary to the fevered imaginings of the 'magic money tree' devotees. What seems to have happened over the past decade is a prolonged experiment in borrowing your way out of a debt problem. Maybe it will work, although I am amongst those who would bet against it, but it certainly is not the sort of circumstance which would suggest that a 'normal' economic recovery or a rapid rise or 'hike' in interest rates is likely.

Pic of the Week

The US is now at or near key employment and inflation targets and the current trajectory means that some brakes will be applied this year in the form of higher interest rates. Consensus expectations are for two modest increases. However, as the chart (courtesy of JPMorgan) shows, the FOMC has more, and higher, expectations. In addition, the FOMC's commencement of the reversal of quantitative easing demonstrates that the central bank is committed to raising interest rates across the yield curve. Bond investors, beware.



Source: FactSet, Federal Reserve, Bloomberg, J.P. Morgan Asset Management.
Market expectations are the federal funds rates priced into the fed futures market as of the date of the December 2017 FOMC meeting.
Guide to the Markets – U.S. Data are as of December 31, 2017.

Market View

	Last 7 days (€)	Last 12 mths (€)	YTD (€)	5Y Ann. (€)
Global equities	-0.8%	+10.9%	+1.4%	+12.9%
US equities	-0.8%	+10.6%	+1.2%	+16.3%
European equities	+0.0%	+12.8%	+2.1%	+9.3%
EM equities	+1.0%	+21.2%	+4.8%	+6.4%
Irish equities	+1.5%	+9.9%	+1.7%	+15.2%
Commodities	+0.1%	-4.0%	-0.4%	-7.7%
Hedge funds	+0.6%	+5.4%	+2.6%	-0.0%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.2497	+4.2%
EUR:GBP	0.8752	-1.5%
EUR:CNY	7.8932	+1.1%
GBP:USD	1.4278	+5.7%
Bitcoin	11,319	-21.9%

Commodities	*Current*	*YTD Δ*
Gold	1,360.39	+4.4%
Copper	6,943.00	-3.0%
Oil	70.69	+6.2%
Wheat	433.13	+1.5%

Central Bank rates	*Current*
Eurozone	0.00%
USA	1.25%
UK	0.25%

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+1.0%	+0.4%	+7.2%
Germany	+0.6%	+1.7%	+2.8%
USA	+2.6%	+2.1%	+2.5%
China	+2.0%	+1.8%	+6.8%

Week ahead: Key events

29/01 US Consumer Spending
29/01 Japan Household Spending & Retail Sales
30/01 UK House Price Data & Germany CPI
30/01 Eurozone GDP & US Consumer Confidence
31/01 UK Consumer Confidence & Eurozone Unemployment Data
31/01 US Employment & PMI Data
31/01 US FED Rate Decision
01/02 Global Manufacturing PMI Data
02/02 US Employment

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