



# Investment Insight

Friday, 11 May 2018

**Crackpot:** Most stock market indices have been in the red since the beginning of 2018. And yet. Remember how they started out the year with such a bang? Investor sentiment was buoyed by strong global growth figures and upward revisions to corporate earnings guidance, while inflation expectations remained so low that ongoing abundant liquidity could practically be taken for granted. So what went wrong? Investors “rediscovered” just what a crackpot Donald Trump really is – that’s what.

This is the narrative of Edouard Carmignac, widely respected founder of the eponymous French investment house, conveyed in a recent letter to investors. In **The Inside Track** we look at what else he had to say.

**Who (k)nows?** Having emerged from a debt-fuelled global financial meltdown, lessons have been learnt and the financial system is much safer? Alas, probably not.

The global economy remains highly levered, and sensitive to interest rate movements. The ability to service the global debt mountain relies on interest rates remaining manageable. However, with the prospect of global inflation driven by improved global trading conditions as well as geopolitically driven oil-price rises, this may place central banks in a bind. How high is the debt versus inflation tightrope they may have to balance? In **Pic of the Week** we look at the figures.

### Quoted...

“The work of a team should always embrace a great player but the great player must always work.”  
– Alex Ferguson

### The Inside Track

Edouard Carmignac founded *Carmignac Gestion* in 1989 and has overseen the growth in their business to €56 billion in assets under management. He writes a letter to investors on a quarterly basis. The following are extracts from his April missive where he reflects on the first quarter of 2018.

Though initially bridled by a team of competent advisors, his [Donald Trump’s] crude outbursts finally began upending financial markets. The mind now boggles at the thought that a major military spending programme – coming on the heels of huge tax giveaways – will likely double the Federal budget deficit by year-end to 5% of GDP! Or at Trump’s campaign to bully his country’s trading partners – mainly China. Or at the spectacle of Silicon Valley (with Amazon as proxy) being scapegoated for what has been judged inadequate economic growth.

The key question, of course, is how worried we should be about this new round of instability. Unfunded tax cuts – implemented moreover at the peak of the business cycle – are admittedly a cause for concern. On the other hand, the extra debt that will have to be issued to pay for them won’t necessarily drive interest rates up very far, particularly if and when the slowdown that we anticipate gets going in earnest, after being temporarily postponed by higher deficit spending. We have even greater doubts about a trade war between the US and China. The two countries are highly interdependent, both as trading partners and in terms of how the US national debt is financed. And then there’s Beijing’s crucial role in dealing with the geostrategic challenge posed by North Korea. As to Trump’s hysterical Twitter attacks on Silicon Valley, they’re clearly far from over, but they won’t do much damage to today’s artificial intelligence powerhouses, either.

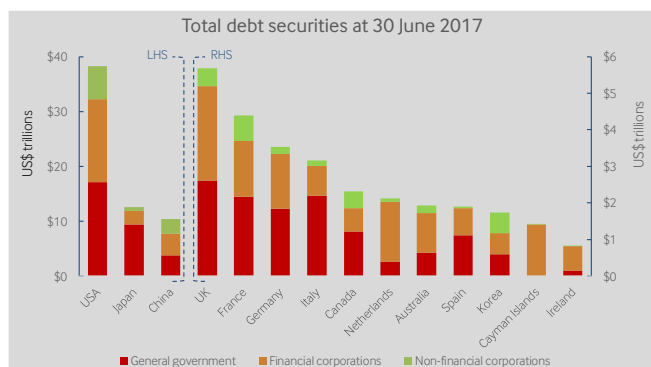
It follows that those sources of uncertainty shouldn’t be overstated. But do we plan to change our investment strategy in response to them? The answer is: not substantially. An increasingly discredited Trump administration, combined with a gradual economic slowdown in the United States, will further weaken the greenback. In our equity portfolios, we will therefore continue to steer clear of European companies that are exposed to both further dollar depreciation and the growth-trend reversal signalled by any number of leading economic indicators. On the brighter side, reduced upward pressure on US bond yields will still be good news for US equities with predictable earnings – including tech stocks – and assets from an emerging world bolstered by a robust Chinese economy. Similarly, oil stocks stand to benefit further from the likely extension of OPEC’s output-cut agreement into next year.

As a result, the current market volatility hasn’t led us to modify our positions significantly. However uncomfortable the prevailing instability may be – for you and for our fund managers – we intend to take advantage of the market overreactions it is bound to trigger, both in how we manage risk and in seeking out attractive buy opportunities.

So in the final analysis, this all points to a rather reassuring outlook.

### Pic of the Week

The Bank of International Settlements (“BIS”) publishes global debt data on a quarterly basis. The data shows that not only has the debt overhang from the credit expansion in the run-up to the financial crisis not been corrected, but it has arguably gotten worse. There have been some improvements, but debt overall (both total and private) has continued to rise globally, with a particularly steep increase seen in EM countries. Looking for good news in this data, maintaining debt affordability will place a constraint on interest rate increases. On the flip-side, it highlights the vulnerability in the financial system and the challenge that central banks will face if inflation becomes elevated. The chart shows, from a selection of the 40 countries monitored by the BIS, who owes what.



### Market View

	Last 7 days (€)	Last 12 mths (€)	YTD (€)	5Y Ann. (€)
Global equities	+2.3%	+4.8%	+1.8%	+10.6%
US equities	+2.9%	+5.4%	+1.9%	+13.7%
European equities	+1.2%	+1.7%	+1.6%	+7.8%
EM equities	+2.3%	+8.5%	+1.5%	+5.6%
Irish equities	+2.0%	-2.2%	-0.8%	+12.1%
Commodities	+1.5%	-1.7%	+4.2%	-6.1%
Hedge funds	-0.9%	-2.0%	-3.8%	-1.9%

Currencies	Current	YTD Δ
EUR:USD	1.1921	-0.6%
EUR:GBP	0.8819	-0.8%
EUR:CNY	7.5626	-3.1%
GBP:USD	1.3516	+0.1%
Bitcoin	9,324	-35.7%
Commodities	Current	YTD Δ
Gold	1,320.67	+1.4%
Copper	6,785.00	-5.2%
Oil	77.33	+16.3%
Wheat	620.00	+45.3%
Central Bank rates	Current	
Eurozone	0.00%	
USA	1.25%	
UK	0.25%	

**Week ahead: Key events**

14/05 UK PMI  
15/05 Eurozone GDP & Industrial Production  
15/05 UK Unemployment & US Retail Sales  
16/05 UK retail Sales & Japan GDP  
16/05 Eurozone CPI & US Housing Starts  
17/05 US Initial Jobless Claims & Leading Indicators  
18/05 Japan CPI & US Employment

<b>Economic indicators</b>	<i>Bond yields</i>	<i>Inflation</i>	<i>GDP YoY</i>
Ireland	+1.0%	-0.4%	+7.2%
<b>Germany</b>	<b>+0.6%</b>	<b>+1.6%</b>	<b>+2.9%</b>
USA	+3.0%	+2.4%	+2.2%
China	+2.2%	+1.8%	+6.8%

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