Rethinking tech
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Foreword

Trade wars continue to cloud the outlook for businesses and consumers. Closer to home, Brexit uncertainty has gone from bad to worse. Our new Prime Minister Boris Johnson's first few weeks in office have been pretty spectacular.

But in our role as global investors we do still see reason for hope. For example, there are many American franchises that have stood the test of time, thanks to superior innovation and management skill. On page 3, we explore the investment opportunities offered by the US tech sector even in the midst of a slowdown, as well as the risks to look out for.

With around $15 trillion in global debt now trading with negative yields, investors are wondering whether it’s worth paying for the privilege of investing in government bonds. Our article on page 5 explores whether we're again in a ‘cash is king’ mode.

On page 6, we try to demystify an unusual and worrying phenomenon happening in the bond markets – one you will probably have seen in the news, inverted yield curves. We look at what this means and whether recent weakness in the eurozone could lead to a global recession.

As the focus increases on responsible investing, businesses have a huge responsibility — and opportunity — to tackle the challenges that face our society. On page 8, we take a look at how tech companies are finding solutions to issues such as water usage. Tech like this is not only an exciting investment opportunity, but can also help solve today’s pressing issues.

Lastly, on page 9 we discuss how US protectionism is harming global economic growth. Although barriers to free trade bring large, ostensible gains to relatively small industries or segments of the population, our article also explores how they also deliver a small, hard-to-quantify loss for every member of a large and silent majority.

I hope you enjoy this edition of Investment Insights. Please visit rathbones.com to explore our latest views on the issues shaping financial markets this year and beyond.

Julian Chillingworth
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Rethinking tech

Vibrant capitalism and Silicon Valley: the secret sauce of US equities

In 1962, a young Stanford graduate and former middle distance runner named Phil Knight sold his car and bought a ticket to Japan, at the time a leading supplier of sprinting shoes. Once there he persuaded a local manufacturer, Onitsuka, to grant him exclusive distribution rights over its Tiger line in the Western US. The business he built on the back of the agreement became the $100 billion powerhouse Nike, while Tiger trainers’ original owner, now renamed Asics, is listed in Japan with a market value of about $3 billion.

This story illustrates the superior innovation, dominance and management skill of US companies. Other enduring American franchises that have conquered international markets include Coca-Cola, Starbucks, McDonald’s, Disney, Apple, and Colgate. The profit margins, return on equity and earnings growth of S&P 500 companies in aggregate are significantly higher than these same measures for the UK’s FTSE 100 Index. For example, annualised earnings growth for the past five years for the S&P 500 was more than double what it was for the FTSE 100 at 8% versus 3.5%.

The outperformance of the S&P 500 over various time periods is eye watering (figure 1). But this raises the question: can this trend continue or, at this point in the cycle, should investors favour cheaper markets with less perceived risk of a price correction, like the FTSE 100? We think it’s more likely that returns for US equities will continue to be structurally higher than in other regions, including the UK, because of America’s size and entrepreneurial energy.

A sense of superiority
Sceptics on US stocks accept their superior quality but worry they are overvalued relative to other markets. For instance, the S&P 500 trades on 18 times forecasted 2019 earnings versus 13 times for the FTSE 100. However, some of this valuation gap reflects the different mix of sectors in the US and the UK. Stripping out information technology (tech) stocks, the S&P 500 would trade on 16.5 times, which is a fair premium in our view for the higher growth and dynamism of corporate America.

The US tech sector now accounts for 30% of the market’s value (using a broad definition), compared with just 1% for the FTSE 100. Purely for diversification reasons, the tech sector makes sense for UK investors pondering US investments — it provides a completely different set of opportunities (and risks, of course) that are not available at home.

Why have technology stocks performed so well? The technology champions like Microsoft, Facebook and Alphabet meet the requirements for an ideal business set out by legendary investor Warren Buffett; they require very little equity capital to grow and thus, unlike most growth stocks, they provide jam today and tomorrow. These tech titans can expand seemingly without capital because their products are intangible, removing the need to invest vast sums in building another plant to serve additional customers. While there are numerous businesses with high returns on capital, there are very few that can also reinvest their income at extremely high rates of return. Stocks like Amazon can do this because they are riding unstoppable trends such as the transition to ecommerce.

The technology champions like Microsoft, Facebook and Alphabet meet the requirements for an ideal business set out by legendary investor Warren Buffett.

Figure 1: Stock market total returns (% in local currency)
US technology companies have outperformed the rest of the US market and other regions substantially over the past decade.
As with all investment opportunities, US tech stocks have their risks. We think these are the four important ones for investors to consider.

1. Sensitivity to the economic cycle
Earnings in the tech sector fell less than earnings for the overall S&P 500 Index in 2009, following the global financial crisis (figure 2). Since then, they have shown less volatility and grown faster than the benchmark. So from an earnings perspective the sector is not the cyclically-sensitive companies that tech stocks of old used to be. While there are more defensive sectors out there, we think that they will hold up well compared to the overall market in a downturn. There are two reasons for this resilience.

First, tech stocks have secular growth drivers powerful enough to override the economic cycle. As the economy becomes digitalised, the suppliers of digital tools and services will comprise a rising share of corporate budgets and consumer spending.

Second, the more economically and trade sensitive technology hardware companies (for example, chipmakers) only account for 20% of the overall tech sector by market value. The other 80% is made up of software and services, which tend to be less sensitive to the ups and downs of the broader economy, with recurring revenue streams.

Visa and MasterCard (which you may be surprised to know are classified as tech stocks) are prime examples of these defensive attributes. The utility nature of their service, processing millions of daily card transactions, coupled with the technological shift from cash to electronic payments helps insulate their earnings from fluctuations in the economy.

2. Overstretched valuations
There are parallels between today and the dotcom era. Tech has significantly outperformed, there is a lot of hype particularly in the arena of artificial intelligence and the Internet of Things, and the last time there were this many loss-making initial public offerings of tech stocks was 1999. However, there are crucial differences. In aggregate the tech stocks was 1999. However, there are crucial differences. In aggregate the tech sector was burning cash in 1999 whereas today cash generation and profitability are strong. Today it’s trading at 24 times current earnings, versus 50 times reached in 1999 at the height of the internet bubble. The competitive landscape was also very immature then, and it wasn’t obvious who would emerge as the winner in online search or ecommerce. These leaders have now been established.

3. Obsolescence
We believe obsolescence is a risk, but it’s more applicable to hardware manufacturers than internet platforms and software vendors, who have much wider moats. The barriers to entry for the latter include not only product design, but having the advantage of being a first mover and so-called network effects, where value accrues the more people use those products or services. For instance, even with unlimited capital at its disposal an upstart business would be hard-pressed to dislodge Facebook’s dominance in social media and still make an economic return.

4. Anti-trust regulation
To level a charge of anti-trust, regulators need to show that consumers are worse off. But today’s high-tech businesses, with their complexity of design, operation and business models make anti-trust law hard to apply. The main difficulty with showing market abuse is that consumers flock to their services precisely because they are either free like Google and Facebook or offer material savings like Netflix and Amazon. We’ve written a lot about the risk of a ‘big tech breakup’ in a series of articles in Investment Insights over the past year, with the conclusion that whether US tech giants emerge unscathed by the increasing scrutiny of anti-trust regulators may depend a lot on political machinations in the US and abroad (see “Time to break up?” in last quarter’s edition). There may be further volatility ahead, but we doubt any of them will be going extinct anytime soon and valuations have already compressed some way to reflect regulatory concerns.

In our view, America remains the engine room of global capitalism, and one that global equity investors should have exposure to. Moreover, without it, UK investors would forfeit exposure to a sector that may be instrumental in driving long-term returns. We believe that in general technology stocks offer defensive growth at reasonable valuations. Within the sector, our preference is for software and service providers with strong balance sheets, fat profit margins, big market shares and plenty of road ahead for disrupting traditional industries.

In our view, America remains the engine room of global capitalism, and one that global equity investors should have exposure to.
Is it worth paying for the privilege of holding government bonds?

We’ve all heard the phrase ‘cash is king’. It gets used a lot when investors think the prices of other assets are getting too high and they would rather sit on cash while waiting for prices to fall.

This is very much a ‘cash is king’ moment. We would argue that government bond yields are unsustainably low. Some $15 trillion of global debt is now trading with negative yields – yes, negative (figure 3). That means buyers of these bonds are paying for the privilege of lending money to the issuers of this debt. The return on their investment, if held to the bond’s maturity, is guaranteed to be negative.

Back in the day, before this ‘new normal’, if a borrower didn’t pay back the full amount of the loan that was called a default. Now it’s just called a negative yield. Central banks have cut so deeply into interest rates that there is nowhere else for them to go but to the subterranean territory of negative rates. You could argue this is default in a different guise. The big question is: how much lower can rates go?

The cost of carry

This brings us to what is known in the markets as the ‘cost of carry’. It is the cost of holding an asset, including financial costs (such as interest rates) and storage costs (for example, to store commodities in a warehouse). If an asset has a negative yield, there is a large cost of carry compared to an asset that yields a positive return. At what point does it make financial sense to take cash out of the bank and pay to keep it in a safe deposit box?

At some point this will cost less than leaving the money in the bank at negative rates (which is actually happening in Switzerland and elsewhere where central bank rates are negative). At some point central bank rate cuts will start to become useless.

We may be nearing that point in Europe. That’s why outgoing European Central Bank President Mario Draghi’s parting shot was to call for fiscal easing (governments loosening their purse strings) to help economies; central bank stimulus could be at its limits.

Cash rates in the UK are still positive, albeit not that positive with the Bank of England base rate at 0.75%. This is well below inflation, eroding the purchasing power of cash deposits. But we would argue that cash is king in the UK right now too. Cash rates may be below inflation, but yields on gilts that mature as long in the future as 12 years are below cash rates (read more about this unusual inversion of the norm and what yields are telling us in ‘Revenge of the bond nerds’ on page 6).

The Brexit factor

We see risks that UK yields could rise (prices fall), for example if Brexit turns out not to be the unmitigated disaster for the UK economy that current ultra-low yields seem to be anticipating. Or inflation expectations go higher. At least you get some return for holding cash in the UK; government bonds – which yield even less – are an unattractive option. Of course, gilt yields could keep going lower (prices higher), but we don’t think the economic fundamentals are on their side.

With the global economy slowing, and an outside chance of recession, there may also be better opportunities for those who wait to invest their cash in assets that offer better returns.

Right now the additional return on offer for investing in corporate bonds rather than safer government debt is the lowest it’s been in about a year. That doesn’t square up very well with all the talk of recession risk – corporate bond markets seem to be taking a more positive view. Equity markets have also continued to rise so far this year, again defying recession talk for the moment. In both cases, these markets are vulnerable if recession does come, or even a deeper slowdown from what’s currently being experienced.

However, with yields so low or even negative, government bonds may not provide the diversification benefits they have in the past. To offset a big fall in stocks you need a huge fall in government bond yields to compensate for that risk. For reasons discussed above, that may not come through. Cash just might be king.

Figure 3: Are you worth it?

Around $1.5 trillion of global debt is now trading with negative yields. That means investors are paying for the privilege of lending money to the issuers of this debt.

Source: Bloomberg
Revenge of the bond nerds

Could the yield curve cause a recession?

The yield curve has traditionally been a bond nerd’s playground. It has always struggled to go mainstream. But lately there’s been a lot of talk in the newspapers and on the radio about ‘the yield curve’ and how its ‘inversion’ is tolling our doom.

Earlier this year we wrote about how an inverted yield curve is one of the most reliable harbingers of a US recession (see our article ‘Why US bond yields are scaring some investors’). This time, we ask the question: if many more people are aware of a measure that typically foreshadows a recession, could they cause a recession by simply reacting as if one was coming?

Some people think an inverted yield curve – the unusual situation where yields on longer-dated bonds are less than yields on their shorter-dated counterparts – can cause a recession through the banking system. Banks make money by taking money from depositors and lending it to businesses and households. This means they pay short-term interest rates in expenses (deposit rates to accountholders) and receive long-term interest rates in revenue from the mortgages and business loans they make. There is substantial evidence that net interest income — the amount banks make in profit between these two rates — falls with the yield curve.

Furthermore, a survey by the Federal Reserve Bank of St. Louis found banks said they would tighten their lending standards when the yield curve inverted. That would mean fewer loans and therefore less economic activity if the curve were to invert. But net interest income isn’t the same as the actual operating profit banks make. Banks hedge and banks trade. That means the evidence for banks causing recessions by reining in lending when the yield curve inverts is pretty slim.

Most people – including the academics who have done most of the work in this area – don’t think the relationship between the yield curve and the economy is causative. It is just indicative. There are four reasons why it might indicate, but not cause, a forthcoming recession:

(1) An inverted yield curve could mean that investors think the central bank is making a policy mistake, raising rates too far, choking off growth and inflation, and will have to start cutting in the future.

(2) It could mean that inflation is too high today and that will entail a short period of higher rates, which will ultimately choke off growth and lead to lower rates and lower inflation.

(3) It could have nothing to do with monetary policy. It could simply be a reflection of sentiment: the perceived safest asset in the world is the US 10-year Treasury bond. When people believe there is increased risk of a crisis or a recession, they shift their assets into this bond. They prefer a 10-year bond to a 1-year bill, say, because it offers more protection if interest rates fall. This is our favoured theory.

(4) The yield curve could be a proxy — a stand-in — for measuring how much return you can get by investing your money relative to the cost of funding. These two concepts are known as ‘return on capital’ and ‘cost of capital’ respectively. Current evidence suggests that return on capital is still well above the cost of capital, a comforting signal.

**It may be coming, but how soon?**
That brings us back to the predictive power of an inverted yield curve. The last nine US recessions have all been preceded by such an inversion (figure 4). Added to that, over the past 60 years that we’ve analysed, the yield curve has only inverted twice without a recession arriving (in the trade, we call that a false signal). In economic forecasting, which can be akin to predicting when earthquakes will strike, this is a pretty spectacular record.

What is unusual today – and definitely worth noting – is that this time round the US Federal Reserve (Fed) is starting to cut rates when there is no clear macroeconomic indication that it has hiked rates too far. That is one reason to think the recent inversion may turn out to be a false alarm.

**Figure 4: Predicting the next economic downturn**
An inverted yield curve has proved to be a reliable indication of recession, but not its timing.

<table>
<thead>
<tr>
<th>Date of inversion</th>
<th>10y−1y</th>
<th>5y−3y</th>
<th>Start of recession</th>
<th>Number of months from inversion to recession</th>
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<tbody>
<tr>
<td>Dec ‘56</td>
<td>Sep ’56</td>
<td>Aug ’57</td>
<td>8</td>
<td>11</td>
</tr>
<tr>
<td>Sep ’59</td>
<td>Jun ’59</td>
<td>Apr ’60</td>
<td>7</td>
<td>10</td>
</tr>
<tr>
<td>Nov ’65</td>
<td>Dec ’65</td>
<td>No recession</td>
<td>21</td>
<td>22</td>
</tr>
<tr>
<td>Mar ’68</td>
<td>Feb ’68</td>
<td>Dec ’69</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>Feb ’73</td>
<td>Mar ’73</td>
<td>Nov ’73</td>
<td>17</td>
<td>15</td>
</tr>
<tr>
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<td>Dec ’88</td>
<td>Jul ’90</td>
<td>14</td>
<td>False signal</td>
</tr>
<tr>
<td>Jun ’98</td>
<td>May ’98</td>
<td>No recession</td>
<td>24</td>
<td>24</td>
</tr>
<tr>
<td>Feb ’00</td>
<td>Feb ’00</td>
<td>Mar ’01</td>
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</tr>
<tr>
<td>Dec ’05</td>
<td>Dec ’05</td>
<td>Dec ’07</td>
<td>24</td>
<td>24</td>
</tr>
</tbody>
</table>

**Average** 14 15

Source: Datastream and Rathbones.
There is one thing that a yield curve inversion can't help with though: timing. The yield curve can roughly tell you what’s in front of it, but not how far away it is. The time between a yield curve inversion and recession tends to be long (about 14 to 15 months, on average) and it has been getting longer with time. Spending more than a year — and sometimes up to two years — in cash can mean giving up a lot of potential returns. That makes the yield curve a difficult tool for investors to use.

Europe, you are the weakest link

Meanwhile, amid a weakening environment for the world’s major economies, Europe looks like the weakest link. But if it breaks, will the rest of the globe fall into recession with it?

Last quarter, there were tentative signs that some leading indicators of eurozone activity had found their floor and economic data were starting to beat consensus expectations. That proved short-lived, as we expected. Some of the economic indicators that our analysis suggests are best at providing information on the outlook for the eurozone economy suggest that activity is slowing further, to a dangerously weak rate of growth.

Recession is a distinct possibility, although a renewed programme of monetary stimulus against a backdrop of decent employment and wage growth should stave it off — for now.

We don’t see much risk of Europe entering into a protracted Japan-style deflationary bust. With monetary policy remaining accommodative, money supply should continue to grow above the rate of inflation and lending should remain positive too. Persistently positive inflation expectations, and the appreciation of real assets such as property, also stand in stark contrast to Japan’s protracted deflationary bust of the 1990s (figure 5).

Nevertheless, Europe’s well-known structural weaknesses are now combined with cyclical malaise, and that leaves the region vulnerable to an external shock — most likely to originate from China.

Europe’s well-known structural weaknesses are now combined with cyclical malaise, and that leaves the region vulnerable to an external shock — most likely to originate from China.

This begs the question that if the eurozone does fall into recession, would it drag US or global economies with it? And, getting to the crux of the matter, would it cause a widespread bear market in risk assets?

Establishing the direction of causality in macroeconomics is hard given the innumerable interconnections in the system. At face value, the sheer size of the eurozone points to the potential to influence the global system — it accounts for 11% of global GDP. On the other hand, it has accounted for just 6% of GDP growth since 2008. The cross-border assets and liabilities of its banks are much lower than they used to be, and exports to the eurozone account for just 1% of US GDP and 2% of China’s. Japan had comparable economic heft in 1990, yet international spillovers from its recession and subsequent ‘lost decade’ were small.

Our econometric tests for causality suggest that shocks to the US or global business cycle are more likely to come from China.

**Figure 5: Growth in eurozone bank lending suggests no ‘Japanification’**

We don’t see much risk of Europe entering into a protracted Japan-style deflationary bust.

Source: Refinitiv and Rathbones.
Responsible capitalism

How to solve the world’s greatest problems and turn a profit

Responsible investing isn’t all about the risks. Increasingly, people are starting to cotton on to the massive challenges that face our society and they are demanding change. Businesses have an enormous part to play in this. They are the conduit for everything — from our food to our electronics, from keeping the lights on to how we get to work in the morning. The opportunities are great for companies that can find solutions to the world’s problems, particularly with technology.

Everybody wants to invest in technology companies and every company wants to be one. For example, by squeezing a fruit packaging business into a tech company’s clothes, Juicero won $120 million of venture funding. It turned out that Juicero’s fruit smoothie sachets worked better if you simply used your hands — especially if your Wi-Fi happened to be on the blink. This is just one of countless cautionary and typically hilarious tales.

An exciting development

We think it’s helpful to hunt for ways that software and modern gadgets can solve the world’s problems that are related to industry and agriculture. Some of the most exciting developments take place in what many consider humdrum sectors.

Water heating isn’t exactly a sexy subject, but it combines two of the most important fronts of the resource efficiency fight — water and energy. Some companies in this sector are leading the way in electric, gas and solar appliances, with innovations that slash power bills for people and businesses alike. Heating water is energy intensive, so quality boilers can significantly reduce the day-to-day emissions of households and small companies.

As the population grows — and developing nations become richer — the demand on the Earth’s fresh water is expected to grow significantly. By 2030, global water demand is forecast to be 40% higher than sustainable supply unless we change our practices dramatically, according to the UN Environment Programme.

Water treatment businesses have a huge role to play in improving water quality and reducing the strain on our most precious resource. Water treatment is an area that is expanding rapidly and should continue for years to come.

Thankfully, there is plenty of scope to streamline how we use water. In the US, almost a fifth of fresh water supply is lost through leaking pipes and theft. In Brazil, such wastage accounts for nearly half. That could be a big opportunity for smart-metering companies. These digital tools help households and businesses keep track of their water use, saving money and water.

By far the greatest use of water is for growing and raising the food we eat. Watering the fruit, nuts, grains, grass and animals that are destined for our stomachs accounts for somewhere in the region of 70% to 80% of all the water we use worldwide. Technology can have a massive impact here as well.

One Silicon Valley company is tapping into this need with location, tracking and land survey services. Think the highly calibrated machines that engineers use to take exact measurements of ground levels and ensure buildings match the plans. Rather than simply throwing water and nitrogen around liberally, farmers can be much more sparing, saving them money and helping conserve the world’s resources. Technology like this is not only an exciting investment opportunity, but it really gives us hope about our ability to reduce our impact on the planet.

It’s not about companies that ‘pivot’ to tech — that pretend to be something they’re not. You need to look for those companies that are taking good technology out into the world to solve real problems.

You can read more about the growing trend of US companies embracing sustainable practices in our recent publication In pursuit of green and why we see responsible investing as a big opportunity for long-term investors in our latest report Responsible capitalism.
Economic pain without any gain

Evidence is piling up that American protectionism is lowering global economic growth compared with what it would’ve been without all the trade uncertainty that comes with it (figure 6). It could also be hurting the very people it professes to help.

The practice of shielding a country’s industry from foreign competition through tariffs and other barriers to free trade brings large, ostensible gains to relatively small industries or segments of the population. But at the same time it delivers a small, hard-to-quantify loss for every member of a large and silent majority. When all of those small losses are added up, they invariably far outweigh the ostensible gains. In the run-up to the 2016 US presidential election, we highlighted this danger in our report Trade of the century, and sadly it’s now coming to fruition.

According to research carried out by the Federal Reserve (Fed), trade-policy uncertainty in the first half of 2018 lowered the level of global GDP growth by 0.8% into the first six months of 2019. That drag would have started to ease if it weren’t for an escalation in trade tensions between May and August this year. However, the renewed uncertainty may push GDP growth down further in the second half of 2019 and into 2020. The Fed study also estimated that trade uncertainty has caused a drag of 1.8 percentage points on investment growth for the average US company.

Unexpectedly, the US may have scored an own goal of sorts with its tariff policy. According to a study published by America’s National Bureau of Economic Research (NBER), the negative impact on demand from trade uncertainty is greater in the US and other advanced economies than it is in emerging market economies. This tallies with evidence that China has actually increased its share of global trade in 2019. It is adept at ‘transhipping’ – using affiliates in other countries to export the end product.

The NBER found that US tariffs have almost completely passed through into domestic prices, meaning the full impact has so far fallen on domestic consumers and importers. There has so far been no impact on the prices for foreign exporters. US producers have also raised their prices in response to reduced competition from importers. As America’s supply-chain network has been disrupted, competition from imported varieties of goods has fallen and domestic prices have gone up. The NBER estimates that US real incomes (income after inflation) fell $1.4 billion per month over the final half of 2018.

Out of pocket

Put another way, rising tariffs are taking money out of US consumers’ pockets. As trade negotiations broke down in May and tariffs on $200 billion of Chinese imports increased from 10% to 25%, the typical US household incurred an annual cost of $831, according to research by the Federal Reserve Bank of New York. That’s $106 billion in total – or 0.8% of all US household spending, which is a pretty significant amount.

Most of this cost is from what economists call a ‘deadweight loss’, which occurs when you have to buy a substitute good from a less efficient producer at a higher price. Even if the government passed back the proceeds from the tariffs to consumers, it would only offset a small amount of the cost.

In other words, it’s economic pain without any gain. And this pain may be about to spread. We’ve noted that the anti-trade rhetoric emanating from the White House in August was more focused on the EU. Tariffs on cars and aeroplanes are a distinct possibility. Against the threat of further escalation, investors are likely to continue to demand extra compensation for the risks to future earnings.

Stocks with international earnings most sensitive to the ebb and flow of the business cycle are most at risk. Although the American economy is being hurt by its own trade policy, continental European, Asian and emerging equity markets are among the most vulnerable to a spread of the tariff war. We continue to see US equity markets as one of the best places for stable and reliable earnings growth – the tech sector in particular. You can read more about why that is in our lead article on page 3.

Figure 6: World trade and industrial production

Tensions between America and China are beginning to affect the world economy and there is evidence that global trade volumes have fallen this year.

Financial markets

The S&P 500 Index of leading stocks set a series of record highs from the beginning of July as the Federal Reserve (Fed) hinted that it would reduce rates and optimism grew for a trade truce between America and China.

Stock markets around the world were volatile over the rest of the quarter. All major US indices — the S&P 500, Dow Jones Industrial Average and Nasdaq — recorded their worst trading days of the year in August as concerns over trade, geopolitical tensions and the possibility of recession rose. However, they recovered some lost ground in September as the US and China agreed to resume trade talks.

A warning sign?

Investors have been seeking the relative safety of the fixed income markets. This strong demand has pushed yields on a large proportion of bonds issued by governments around the world into negative territory. Anticipation of a sharp future slowdown has also led to an inversion of the yield curve in the US and Britain, where long-term bond yields fell below those of short-term ones. Such inversion typically signals investors see recession approaching, but not always.

Nervous investors are also reaching for the safety of the dollar. The yen and Swiss franc, habitual sanctuaries, are among the few currencies that have risen against it. The price of gold, another haven, is at a six-year high. That of copper, sometimes considered a barometer of global industrial activity, is down from its recent peak.

Oil prices rose by almost 20% after two drone attacks on facilities owned by Saudi Aramco, Saudi Arabia’s state oil giant. The strike knocked out more than half the kingdom’s production capacity — equal to 6% of global output. The incident threatened to spark conflict in the Middle East, as America and Saudi Arabia blamed Iran for the attacks. However, tensions seemed to cool towards the end of the period.

Source: Datastream and Rathbones.

Past performance is not a reliable indicator of future performance.
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The above information represents the current and historic views of Rathbones’ strategic asset allocation committee in terms of weighting of asset classes, and should not be classed as research, a prediction or projection of market conditions or returns, or of guidance to investors on structuring their investments.

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Taking the next step

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