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INVESTMENT NEWS

Investment & Economic Outlook

The daffodils are starting to come up in my lovely Suffolk garden, I just hope they survive the Arctic weather we are predicted later this week! We are flat out on tax year end and new client reviews however it's over a quarter since we updated clients on what is happening in the investment world. We have seen significant volatility in the markets so believe the following may be of interest. I recommend reading these notes in conjunction with our Active Asset & Factor Update.

Interest Rates And Inflation

The central banks stance is shifting from quantitative easing (QE) to a quantitative tightening (QT) as inflation seems to be picking up. We don't know what effect this will have on markets but it is fair to assume that there will be less money sloshing around which may lead to lower prices.

The Bank of England's latest meeting saw a discernible change in tone as the bank warned that more interest rate rises are on the horizon. The bank's Monetary Policy Committee (MPC) kept interest rates unchanged at 0.5% but stated that interest rates would need to go up sooner and in bigger steps than it had previously expected in order to counter inflation. Following this statement, investors saw the probability of a rate hike in May rise from 50% to 75%.

The MPC expects inflation to fall this year but is concerned that it will remain above the 2% target level. Oil price and wage inflation are likely to pick up while the UK is benefiting from the current upswing in global growth. With a similar policy is already very publicly underway across the pond, and with the ECB likely to reduce stimulus later in the year, it's clear that the direction of travel is a reduction in monetary stimulus and there are likely to be repercussions for financial markets.

Consumer & Government Borrowing

In 2017, levels of consumer credit in the UK rose to a record £200 billion and is likely to increase in 2018. Consumers are now so used to zero level interest rates, any increase in rates is going to come as a shock.

The Labour manifesto seems to offer massive increases to the UK debt whilst the current government seem singularly unable to curtail overspending.

Estimates suggest that the US budget deal will increase next year's budget deficit to around $1.2 trillion and cause debt to rise from around 76% of GDP today to over 90% by 2027.

One day we will all have to stop borrowing more money but, in the meantime, the party on the Titanic continues!

UK Demand & Output

At the half way stage of the Q4 reporting season, UK companies have on average surprised positively on both sales and earnings, with 60% of companies exceeding expectations. This continues the trend which belies the doom and gloom merchants.

Anecdotally, the domestic economy seems buoyant (particularly if you need a tradesman in a hurry!).

What Caused The Recent Blip?

The main reason for the drop in equity valuations seems to have been the release of US employment data on February 2nd, revealing a sharp increase in annual hourly earnings growth from 2.5% to 2.9%, suggesting a very tight labour market. There was however a mitigating factor in the news that average weekly hours worked fell from 34.5 to 34.3.

Wage inflation means central bank tightening of monetary policy which means less money around and hence lower growth.

It also should be said that there hasn't been a significant correction in equity prices for some years and many investors are looking for reasons to seek safety.

Summary

Global trade is currently strong and there seems no immediate reason for it to reduce. Irrationally however there is an air of expectation that there may be trouble ahead.

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