

COMMENTARY

Jupiter Merlin Portfolios

For the month of January 2019

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Jupiter Independent
Funds Team

A robust start to the New Year

2018 was dismal for global equities, the last quarter particularly. But investors collectively approached the New Year seemingly determined to put the misery behind them and, in the words of the Madness song, “to take the blues away”. They succeeded. January posted the strongest month’s performance in more than three years. However, investors usually require more than simply thinking positive thoughts as a reason to commit to markets. What changed? First, optimism remains for a settlement in Trump’s tariff trade war which, if achieved, would be a significant pressure off the global economy, particularly for China, Germany and the US itself. We wait and see. Second, the policy of the US Federal Reserve (the Fed) seems to have turned on a sixpence.

The Federal Reserve pivots policy

Last month we wrote how Chairman Powell’s monetary policy committee had rebuffed a torrent of Presidential tweets putting pressure on them to halt the programme of raising interest rates. The Committee’s statement issued on 19th December was a confident reaffirmation that the policy remained intact, allowing the inference that even if markets were no longer likely to see four quarter point interest rate rises in 2019, more than none remained probable. Further, the programme of quantitative tightening (QT) to shrink the national balance sheet was still on track. By 4th January, however, Powell’s tone had changed; gone was the confidence, replaced by such phrases as “patience” with interest rates and “no pre-set path” with QT. Following the interest rate setting meeting on the 30th January, Powell left markets in little doubt that progressive policy had ground to a halt, indeed some commentators believe the Fed’s next move would be to cut interest rates.

Was it turbulent equity markets which caused the change? Or does the Fed see the US economy as being in trouble? Or was Powell nobbled by the President? It’s difficult to say. It’s true the US economy is forecast to decelerate in 2019 and analysts have been steadily cutting their estimates, however it’s still likely to grow at around 2.3%. Inflation has slowed since mid-2018 and is in line with the 2% target; unemployment is at a generational low though, rising a tad from a mid-year rate of 3.7% to 4%, it has possibly bottomed. Economic data released at the month-end – inflation, employment, wages and business confidence – were all respectable, despite January’s virtual shut-down in the US public sector as the Democrats and Trump faced each other down about funding his Wall along the Mexican border.

Powell’s latest language is couched in reasonableness and sufficiently vague to prevent painting himself in to a policy corner, but at no stage has he allowed the inferences about policy being on hold or reversed to be dispelled; equally, nor has he been explicit that interest rates cannot still go up should the need arise. But let’s suppose, in the light of global growth slowing, this really is the peak of the monetary policy cycle in the West, where does it leave us?

Is policy tightening over before it really started?

Of the four major developed markets’ central banks, the Fed has been the most ‘aggressive’ (and even that’s only on a relative scale): nine interest rate rises since December 2015 still leave base rates at only 2.25-2.5%, barely a half point ahead of the rate of inflation; the European Central Bank has only just finished its programme of pumping money into the Eurozone economy and interest rates are still -0.4%, and even in this state the eurozone economy is in atrophy; in the UK, we have a base rate at 0.75%, only 0.25% higher than in the nadir of the financial crisis in 2009; Japan, the most indebted nation on earth, has negative interest rates and is still pumping money in to the economy for a headline growth rate of zero. Policy tightening, *real* tightening? It barely started! It’s difficult to avoid the conclusion the world economy is hooked on rock-bottom interest rates and central bank support but with diminishing returns; it’s disquieting to see how sensitive economic health is when the support is weakened (either by increasing interest rates or reducing the supply of liquidity), however gradually. Effectively halting that process, as Powell has done, lets investors think whatever else happens, it won’t be the Fed which causes future problems. However, should economic conditions still deteriorate markedly, it is clear central banks have left themselves precious little firepower to help.

In these shifting sands, we believe the Jupiter Merlin Portfolios are appropriately structured to deal with the challenges. We seek to invest in funds run by experienced managers with a blend of styles but who share our core philosophy of trying to capture good performance in buoyant markets while minimising as far as possible the risk of losses in more challenging conditions. The Portfolios are certainly not immune from market volatility but over time they are anticipated to be less volatile, and of course we are long-term investors, investing in managers who themselves are long-term investors who can use such volatility as an opportunity.

We thank you for your continuing support.



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