WIGMORE ASSOCIATION

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Wigmore CIO Briefing

September 2020

The Wigmore Chief Investment Officers held a series of webinar briefings with our leading external research providers during September. Notable insights from these briefings are described in a summary for each research firm below.

Wigmore Association investment insights

The Wigmore Chief Investment Officer's (CIO's) group shares investment insights between our firms across many investment areas. We last met as a group in person during February 2020. As the global pandemic curtailed travel, we have been meeting on weekly video calls to continue to share insights. In place of a face to face meeting with each other and local strategists, economists and fund managers, we ran a series of webinar briefings with our leading research providers across economics, market strategy and political consulting.

Our briefings were with:

- Bank Credit Analyst (BCA)
- Gavekal Research
- Hedgeye
- Strategas Research Partners
- Capital Economics

Capital Economics views on China

On the 10th September, a briefing for Wigmore CIOs was held with Mark Williams, Chief Asia Economist. Capital Economics is a global economic strategy consulting firm, founded by Roger Bootle, with a team of over 70 economists in 5 countries. All Wigmore firms subscribe to Capital Economics in a group arrangement.

China appears to be leading all other countries out of the pandemic with an extremely resilient economic rebound. It is the only country in Asia that has a positive yearly industrial production growth rate, and this is also supported by high industrial profits data released last week. Issues of growing geopolitical tensions and foreign companies shifting their supply chains are a concern. There have been beneficiaries though as Chinese equities and bonds are transitioned into global market indexes, prompting many investors to gain exposure to China.

Chinese Decoupling

There are headwinds for China's rebound, as many industrial companies are considering 'reshoring' or 'near-shoring' their production from China. The pandemic and geopolitical tensions between China and the US are accelerating as China is asserting itself more aggressively both internally in Hong Kong and overseas. Diplomatic efforts are failing to improve the perception of China, particularly in Australia with Chinese brute force trade tactics, assertiveness amongst Pacific nations and with Chinese corporates from Huawei and beyond under much greater scrutiny from foreign governments.

Chinese goods imports into the US have collapsed since the first round of trade tariffs decoupling of China, however the rest of the world is importing Chinese goods at levels near the highs of the last five years. This is partly because many countries still require the dominant source of manufacture of medical equipment, pharmaceuticals and many consumer and industrial goods.

China was always going to decouple from the rest of the world as they build a stronger internal economy with a higher proportion of household consumption, however the pandemic has accelerated this trend. The US would have a tendency for separation as China's GDP grows to rival that of the US, and no Chinese leadership is likely to align to US views of the world. The robust Chinese economic recovery and the distraction of the US and rest of the world on their own pandemic recovery, does embolden China to press their advantage.

Where to next?

As supply chains move from China, there will be many beneficiaries close to home in each region, and also for India as a very large country with supportive demographics and a large agrarian labour force that could be pivoted to manufacturing. However, these changes will take many years, and the obvious near term winners such as Vietnam, may not win as much business longer term that India could.

Careful Chinese stimulus efforts

China is very conscious of high debt levels within their corporations and government related bodies that arose from the last two significant stimulus periods post the 2008 financial crisis and the 2015 oil crash and near recession. The government and People's Bank of China (PBOC) have recognised distortions in the financial system that arose from these last two debt driven stimulus efforts. Therefore, they have emphasised their efforts are not to have a massive surge of investment or flood the Chinese financial markets with liquidity. However, we do note that local government financing vehicles are being activated to fund provincial infrastructure and capital investment programs. China is also talking about moves for the Chinese Communist Party (CCP) to have a say in the hiring and firing of senior executives in large private corporations. The economic and public health success of China in dealing with the pandemic relative to the rest of the world, has emboldened China to double down on the centralised state-led economic model.

Strategas' view of the US Elections

Daniel Clifton, Partner and Head of Policy Research at Strategas presented as a guest speaker in a webinar hosted by Turim about the outlook for US elections on Thursday 17th September. Turim, based in Brazil, is a client of Strategas Research. Strategas is an institutional brokerage and research firm with a strong grounding in macroeconomic and policy research, asset management strategies and capital markets execution.

Strategas highlight that the US Presidential system is not won by popular vote, as it is determined by the electoral college system. This system assigns a number of votes to each state, generally aligned to the population of the states. As such, it is possible for a President to win the election with a majority of electoral college votes but lose the popular vote. This happened in the Bush – Gore election in 2000, which was only the second in history for the President to win. Therefore, we should focus on the swing states and less on the popular vote polls. According to Strategas, at the time of the call, the likely election result based on swing state estimates is still close, even though the popular vote polls still have Biden (49.4%) ahead of Trump (42.9%) as at 19 September. Therefore, we should focus on the swing states of Pennsylvania, Michigan, Wisconsin, Arizona, Florida, Georgia and Ohio. Commonalities across these states are a legacy manufacturing sector or a large retiree population.

What could tip the election?

This year has a confluence of transformative events, more so than any other election in the last 100 years. There has been a recession, a global pandemic, mass public protests, and the presidential election itself. There were only three other years that as most three out of four of these events. How each of these transformative events favours a Republican or Democrat bias is important. If there has been a recession, the incumbent President is less likely to win, so a slippage of economic performance will favour the Democrat side. If the pandemic in the US gets further out of control towards the election, this will also favour the Democrats. If the mass protests are biased towards violence and destruction of property, then this favours the Republican side with a stronger law and order posture. The markets themselves have been a positive indicator of the result, with the S&P500 performance between August and the election date, highly correlated to the incumbent President winning. All of these factors can change between now and the election itself.

What are the outcomes of the US election

The result itself, is likely to be close, and it will also depend on whether there is a clean sweep of the House of Representatives and Senate along with the President. Putting aside a close result that will likely lead to disenfranchised voters protesting in the streets and adding to social disruption, the Presidential election is only meaningful for fiscal policy and legislative reform if Congress is politically aligned with the President. If not, then a Democratic President for example won't be able to propose and pass legislation successfully if one of the Senate or House is Republican, and vice versa for a Republican President. Then, even if there is a clean sweep, the impact on markets will depend on what policy the administration leads with. For example if Biden leads with a Green Infrastructure bill, this will be very positive for equities, especially in the construction and industrial sectors. If Biden leads with a tax policy that has hikes in corporate tax, capital gains and dividend tax, that will be very bad for equities. There is likely to only be a two year window to implement key legislative changes before the political balance shifts at the Congressional mid-term elections.

Therefore, there are still a lot of variables with this Presidential Election, and we will be watching closely to analyse any biases emerging in the political landscape and markets in coming weeks.

BCA Research

Caroline Miller, Chief Global Strategist at BCA Research, spoke to the Wigmore CIO group on Tuesday 8 September. Sandaire in London are a client of BCA, who are based in Montreal, Canada.

BCA observe that the resurgence in COVID-19 cases in Europe is not being accompanied by the same rise in death rates. They believe that the threshold to institute widespread economic restrictions is very high. There has still been a trough, and potentially a stall, in economic activity in Europe. Their view on the US is that the fiscal outlook is very weak as most of the prior fiscal packages expire this US Autumn (September to November), They expect retail sales to stall unless there is an agreement on a fiscal package.

On currencies, BCA believes the US dollar has entered a cyclical bear market, with the US a counter cyclical currency. That means when the G10 major economies strengthen, the US dollar weakens and vice versa. Noteworthy is that when early in the business cycle, which is better for trade and cyclically oriented currencies (eg the AUD), the US dollar weakens.

Gavekal

Louis-Vincent Gave, Founding Partner & Chief Executive Officer of Gavekal presented to the Wigmore CIO's group on Wednesday 9th September. Turim in Brazil are a client of Gavekal who are based in Hong Kong and London. The most interesting point from the Gavekal presentation was that the notion of the leading 'antifragile' asset class has changed. While this seems an esoteric subject, the idea of an 'antifragile' asset was proposed by Nassim Taleb in his book 'Antifragile', as something that performs well when most other asset classes perform poorly. Historically government bonds have taken that role in investor portfolios, as a diversifier and stronger performer when equities and other asset classes crash. As government bonds have not performed as well this cycle and are much less likely to perform this role in the future, their role as the 'go to' protection asset is called into question.

Gavekal observed other asset classes that have performed well since the March economic and market crash. These are considered as potential new 'antifragile' asset classes. Four strongly performing asset classes that have gone on to make new highs since March 2020 are:

1. Big Technology - MSCI World Technology index
2. Alternative Energy - MSCI World alternative energy index
3. Precious Metals - World MSCI gold miners index
4. China CSI 300 equity index.

Gavekal's interpretation of the drivers of these potential new 'antifragile' asset classes leads to the following conclusions. Big technology is a hedge against the return of the pandemic. Alternative energy is a play on further increasing in government spending on green energy. Gold is a hedge against the uncontrolled simultaneous growth in OECD budget deficits and monetary aggregates. China equities are a hedge against pronounced and sustained US dollar weakness.

Capital Economics

Capital Economics presented their Global State of Play webinar in a broad client briefing on the 10th of September. Capital Economics, headquartered in London, is a research provider to all Wigmore firms through a group subscription. The key observations are that the recovery is strong in China. Capital Economics is more bullish on China growth than the consensus. The China stimulus is lead by infrastructure development, which will continue to support industrial commodities. Capital Economics note that iron ore, copper and oil consumption are up 10% on last year in China. The export side of the equation in China is extremely strong, with China having a record run of export volumes and growth. China still exports the goods that people need, more so in the pandemic period, for example personal protective equipment such as masks and electronic equipment.

Hedgeye

On 16th September Hedgeye CEO Keith McCullough and Managing Director Darius Dale presented to the Wigmore CIOs. Mutual Trust subscribes to Hedgeye's institutional macroeconomic service.

The premise of Hedgeye Risk Management's research offering is that it is structured to provide the research that a leading hedge fund would have at its disposal, and hence the name Hedgeye. A core of the service is the macroeconomic strategy offering that is data driven and utilises a blend of artificial intelligence and proprietary analytical techniques to provide daily updated macroeconomic, equity sector, political and demographic analysis.

Keith described to the CIO group the analytical framework of Hedgeye's macroeconomic research and how it is connected to daily actionable recommendations for global equity, bond, currency and commodity markets.

The grounding element is to frame the backdrop of the economic cycle for each of the developed and emerging market countries, using backtested models of data releases to 'nowcast' GDP and Inflation using around 30 variables for GDP and Inflation. The key insight from this process has inspiration from Ray Dalio's Bridgewater's 'All Weather' portfolio model. Bridgewater's research determined that the statistical principal components of investment portfolio performance can be correlated to the specific environment of growth rate of GDP and Inflation. There are four environments, or quadrants, corresponding to combinations of accelerating or decelerating GDP and Inflation. By backtesting all asset classes and equity sectors performance against each of these four quadrants of GDP and Inflation acceleration or deceleration combinations, one can align investment strategy positions to what is most likely to perform best in this environment. Market signals of price, volume and volatility, sector and style performance provide confirmation of the economic environment signals based on the A:B backtesting of economic environment to market signal.

Where does Hedgeye see the cycle?

At the time of the call, Hedgeye's models for the US economy for the fourth quarter of 2020 were for a slowing GDP, with inflation marginally accelerating over the previous quarter by 3 basis points, with a 55% probability of accelerating inflation, and a 45% chance of decelerating inflation. In a growth slowing but inflation accelerating environment, commodity prices rise, the tech sector rises, and the USD falls, amongst many other specific sector and stock correlations. We have been in this environment for much of the third quarter to September. On the 2nd of October, falling oil prices influenced the inflation signal such that the economic environment flipped to falling growth and falling inflation. This has significant implications for asset class positioning. In particular the USD rises, commodities fall, and the tech sector falls. Leading equity sectors in this environment are Real Estate Investment Trusts (REITs) and utilities.