Investment Report 2019
Art of the Long View

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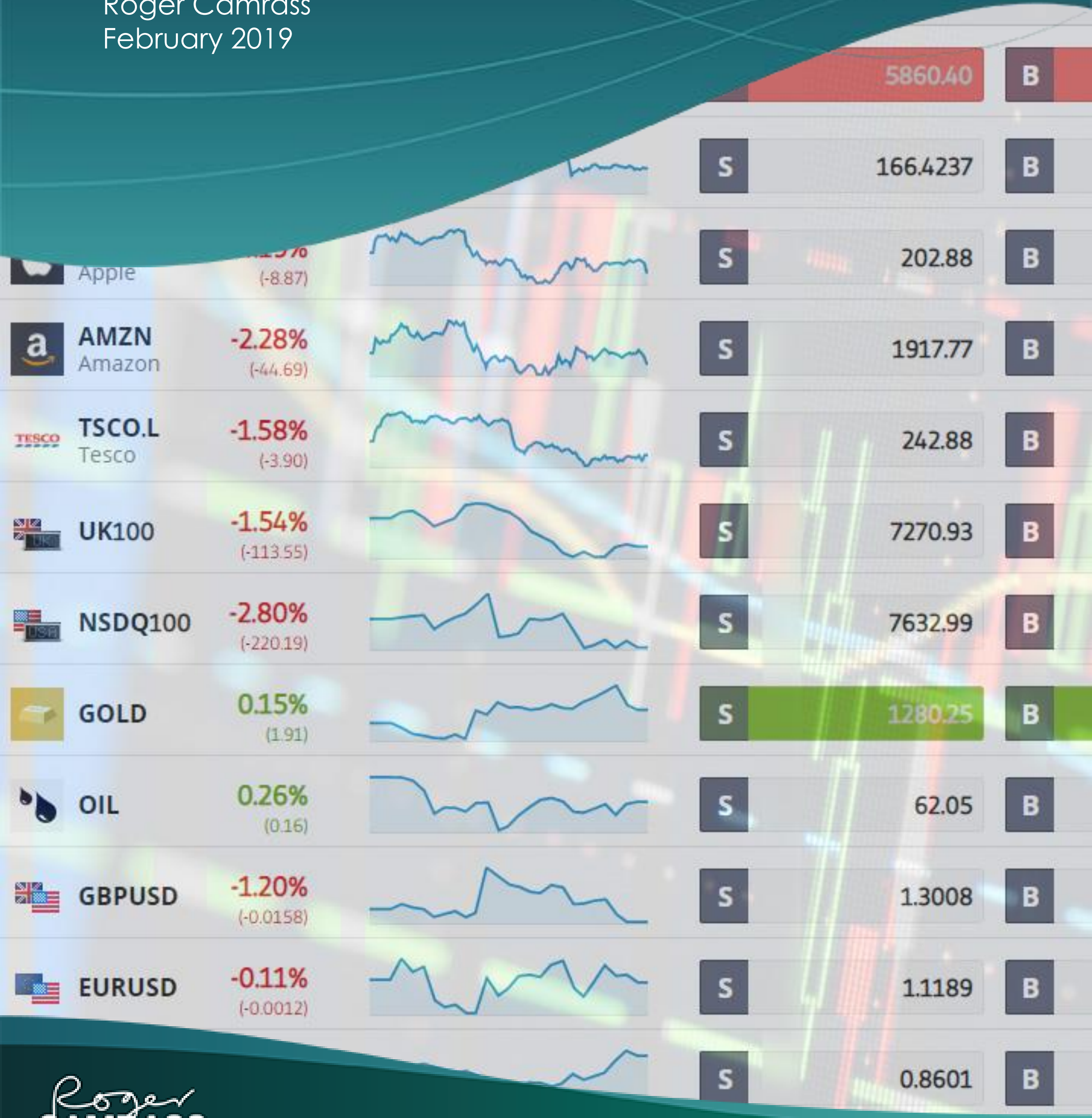

Mature investors have just two parameters in mind when considering investment strategies for the years ahead – often as far as 30 to 40 years. The first is the level of growth of the portfolio over this long duration needed to generate a respectable retirement income. The second is the yield on such investments, or what is commonly referred to as the portfolio yield.

Despite a torrid year for investors in 2018 when global markets declined by over 10%, there have been some positive signals to be extracted from the noise and volatility:

- Emerging markets continue to power global growth, contributing today 69% of GDP increase, and predicted to contribute 77% by 2023. Despite a slow down in the Chinese economy, India and Brazil are in strong positions to contribute to global GDP
- Technology stocks (especially FAANG, BATs and Unicorns) will continue to drive growth in developed and developing economies, occupying an increasing share of S&P500 market value – now approaching 26%, and likely to be 50% by 2030
- Dividends from equities have never been more attractive in countries such as the UK where stocks are undervalued due to heightened risks of a BREXIT no-deal. The FTSE100 stands at the same level as it did in 1999 (around 7,000). Current dividend yields are likely to reach an average of 5% in 2019

Against these positive signals, there are some dark clouds gathering. The Euro zone will enter recession this year as Italy faces a financial melt-down and production in the German manufacturing power house declines steeply due to a weaker Chinese market for machinery and cars. The trade wars between the USA and China could reduce global growth from current level of 6.6% down to 5.5%. Fiscal tightening by the FED in the USA could disrupt debt ridden economies, especially in the developing world. Finally, the growth spurt in the US economy enabled by tax breaks will slow in 2019 from 4% down to 2.2%.

Look back on 2018

In contrast to 2017 which was a bumper year for global stock markets with the DOW and Nikki up by 25% and Dax by 14%, 2018 was a torrid year with flash falls in February and December. Volatility returned to the market after being flat in 2017 making predictions more difficult (the VIX reached 30 in February from a low point of 10).

Figure 1 – Changes in the 2018 market indices

Market Index	*Change in 2016 (Jan-Dec)*	*Change in 2017 (Jan-Dec)*	*Change in 2018 (Jan-Dec)*	*Peak 2008*	*Final level in 2018*
FTSE 100	+14%	+7%	-12%	6,750	6734
FTSE 250	+4%	+13%	-16%	12,000	17,500
AIM	+14%	+24%	-16%	1,200	858
S&P 500	+9.5%	+20%	-7%	1,500	1,960
NASDAQ	+12%	+27%	-9%	2,200	6,635
DAX	+8%	+12%	-18%	8,000	10,580
CAC	+6%	+12%	-12%	6,000	4,730
Nikkei	+3%	+16%	-12%	18,000	20,000

These figures confirm the strength of Tech companies (NASDAQ) during the last decade. They also illustrate the poor performance of large incumbent stocks, as witnessed by a stagnant FTSE100, and a sharp decline in the French CAC. It is difficult to say that 2018 was the end of the longest bull market in recent history, but it did show signs of distress especially in December (the worst trading month since the great depression).

Outlook for 2019

January showed a positive recovery across the Globe with the MSCI index up by 4%. However, investment risk is still endemic due to the following factors:

- FED quantitative tightening (end of QE) could unsettled developing and emerging nations who have high levels of dollar denominated debt. There are signs that the FED will slow its pace of interest rate rises this year due to this risk factor
- China's growth is slowing from 6.6% down to 5.5%. Given that China contributes 27% of global GDP growth this has a strong knock-on effect on markets such Germany (exporting machinery) and commodity prices
- Trade wars between China and the USA are set to continue with crippling tariffs of 25% or more. Trump's unpredictable behaviour undermines confidence that the two sides will come to an amicable agreement. China will persist in IP theft.
- Oil prices are unstable as Venezuela continues its political melt-down and Iran remains locked in sanctions. Saudi is struggling to maintain $60-70 levels to protect its fragile economy
- Europe is in a perilous state as the Italian economy collapses into recession, with Germany not far behind. The Euro experiment looks set to end in failure with only the Spanish and Irish providing better news. Brexit will not help economic stability

Overall, global markets remain relatively buoyant despite a bumpy 2018 with momentum continuing to overtake value investing. However, P/E ratios have fallen to a more realistic level in 2018 (from 29 to 20 in the USA) offering positive prospects for stock growth this year.

The BREXIT effects

Whether you believe in Brexit or not, the prospect for a positive change of this magnitude has always been in doubt. Conditions for successful change require a clear strategic plan; a committed and powerful change leader; consensus around the need for change; a burning platform that necessitates change; and adequate time to achieve successful outcomes. None of these factors were in place during or after the decision to leave the EU in 2016.

Just two years ago a marginal majority voted for BREXIT. The following election produced a hung parliament indicating little enthusiasm for change. The EU has rigorously opposed our exit and placed every possible barrier in our way. The Labour party has carefully avoided any support for government-led negotiations, hoping that the Conservative party will discredit itself. With just a month to the date of exit, nothing yet has been resolved, leaving the possibility of a no-deal. This will cut GDP in the UK for 2019 and probably lead to recession. Meanwhile investment over the last year has fallen away rapidly and many companies are moving staff and operations overseas.

The worst possible outcome would be another general election with Jeremy Corbyn in power, supported by his Marxist chancellor, McDonald. This could put us on course for a Venezuelan style melt-down. Disputes within the Conservative Party may help Labour to achieve its ominous rise to power.

A growing disparity between old and new

Stock market growth in the developed economies (and China) relies heavily on tech stocks, especially digital natives such as Google, Amazon, Alibaba and Facebook. Such growth comes at the expense of incumbents as sector disruption continues apace. Over the last decade we have seen digital natives threaten incumbents in b2c sectors such as advertising and media; retail; travel; gaming and entertainment. There is every likelihood that similar disruptions will take place b2b sectors such as financial and business services; asset management; utilities, automotive, construction and engineering.

In contrast to these dynamic newcomers, incumbents have focused on share buy-backs and consolidations (through M&A) as the principle means of maintaining shareholder value. Our view is that such organisations have little chance of transforming the core of their businesses to respond to external threats. Instead some effort is being placed out at the edge, with start-ups, incubators and joint ventures. However, this is unlikely to produce the growth that tech companies enjoy.

Gartner believes that big banks will be dead by 2030. This is probably an over estimate, but it is likely that such dinosaurs will need to re-adjust their positions radically with respect to digital natives. The consequences of such disparities will be most felt in Europe where complacency is at its highest (in France, Germany, Italy). Given the increasingly bureaucratic nature of European governance from Brussels (Junker and Barnier) and the ECB, it is likely that the EU will fall well behind the USA and Asian powered economies in the coming decade.

China, India and Brazil (members of BRIC) are economies to watch. Given their young populations (50% of Indian population is under 25), the scope for growth and innovation is extremely high. China is creating waves in areas such as Financial Services, Telcom, Healthcare, Retail. Chinese companies may become the major insurgents into Western economies over the coming decade, again threatening incumbents.

The obvious conclusion is to regard large incumbents (S&P and FSTE) as cash generators with limited lifespans (attractive dividend sources); whereas emerging economies and digital natives will be the growth engines of the global economy for a decade or more.

Recommended asset allocation for 2019

Taking the long-term view, we recommend an even distribution of investments across global markets and asset classes, with emphasis on increasing dividend flow (from the UK and USA) and generating growth in the portfolio from digital natives and emerging markets. Given likely volatility and prospect of a bear market, cash reserves may be valuable should markets decline by 25-30%. One significant portfolio adjustment from 2018 is the reduction in European equities across the portfolio given the perilous state of this region.

We can expect the USA to continue its growth at over 2% (against 4% in 2018 due to tax breaks). We also assume a recovery in the Chinese stock market from a low point in 2018, despite weaker national growth. The UK FTSE is likely to remain relatively unchanged as Brexit uncertainties persist.

USA to continue its growth at over 2%

The mix for my personal investment for 2019 will be: 75% equities (high risk strategy designed for growth) and 25% bonds and cash (reducing risk and offering flexibility in a downturn). Dividend yield has been designed to grow from 1 to 3%.

Figure 2 – asset allocation for 2018

Asset Class (SIPPs and ISAs)	2017 allocation	2018 allocation	2019 allocation	Rational
Cash/Short dated strategic bonds	30%	25%	10%	Keep cash reserves for market corrections
Bonds and property	5%	10%	15%	Alternative to cash with some up side
US Equities (S&P, NASDAQ)	25%	20%	25%	Strong dollar, growth expected to continue
European Equities	10%	20%	5%	Signs of recession and potential Euro crisis
UK Equities (FTSE100 and 250)	10%	10%	20%	Undervalued stocks delivering strong dividends
Global/Asian Equities	20%	20%	25%	Powering global growth at 5-6% GDP

National and regional highlights

Large variations persist between countries and regions of the Globe. A broad-based investment strategy is advisable to catch market up-turns (China?) and reduce impact of down-turns (UK and EU):

1. **USA**
   The USA continues to look strong, enjoying a recent 15% growth in corporate earnings due to Trump's tax break in 2018. Unemployment is at an all-time low (4%). Trump is unpredictable and appears unable to steer the ship. However, America drives the global innovation agenda with leading digital firms such as Apple, Amazon, Google and Facebook.

2. **China**
   2018 was a very disappointing year for China with stock market indices down by 24% due to trade wars, declining demand for products and increased debt. The government is stimulating the economy with massive infrastructure projects ($1TR for Silk Road). China continues to steal IP and jobs from the West, especially the USA.

3. **Eurozone**
   Overall decline of 15% across stock markets in 2018 with little prospect of a recovery in 2019 when Italy is in melt-down and Germany enters recession. France is experiencing political turmoil with the Yellow Jackets. Macron is highly unpopular. The ECB is withdrawing quantitative easing – the recent lifeline for a moribund economy.

4. **UK**
   Plagued by Brexit uncertainties, the UK is losing economic momentum. Businesses are left in suspense by inept politicians. Sterling has suffered a 25% fall since the Brexit decision. However, for many FSTE100 companies this has added to profits given majority of revenues are outside the UK. There is a growing distinction between domestic companies such as banks and retailers, and international firms such as Unilever, Diageo, Shell. The good news is that the UK continues to lead on start-ups with 20% of total VC investment across the Euro Zone.

5. **Emerging Markets**
   BRIC economies look set to make a comeback, especially India. Other Eastern economies could add to global growth such as Indonesia. 2018 was a bad year for this asset class. We expect a better outcome for 2019 especially as EM accounts for 69% of global GDP growth today, rising to 77% by 2023.

ABOUT THE AUTHOR

Roger Camrass is a visiting professor at University of Surrey, and a director of Surrey's Centre for the Digital Economy. Roger has over forty years of experience in helping organisations and IT functions transform, ranging from reengineering in the nineties to e-commerce in recent years. He is author of 'Atomic: reforming the business landscape into the new structures of tomorrow', and is a graduate of Cambridge and MIT. Visit www.rogercamrass.com for more background, publications.

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