What does uncertainty do to risks? Newton Investment Management's global real return manager, Iain Stewart, outlines what the current economic and political backdrop may mean.

DOES UNCERTAINTY EQUAL RISK?

The uncertainty of the investment backdrop is perhaps an impression conveyed solely by the media, given financial markets imply investors believe the opposite, says Stewart. High valuations across major markets infer investor optimism rather than nervousness, he notes, and much of this is based on the belief that global reflation is underway. “We’re not convinced by that idea,” he adds.

There are reasons to be hopeful, he believes, pointing to the new U.S. administration’s talk about tax cuts, reforms and increased infrastructure spending. However, Stewart also notes that President Trump’s timescale looks, in his opinion, to be way too optimistic. “Trump is unpredictable and inconsistent, so it is hard to see his plans as a bullish indicator.”

Growth, he argues, depends on more than just the policy backdrop—ultimately it hinges on demography and that is hard to change. “The economy isn’t a machine and there are all sorts of unintended consequences of policy. Just look at quantitative easing—it was supposed to be a one-off and it has morphed into a semi-permanent state that is increasingly hard to exit.”
Interestingly, Stewart points out, while asset support continues on a global scale, the actors have changed. What started with economies such as the U.S., UK and even China has moved to the Bank of Japan and the European Central Bank. China also continues to take action, with Stewart calling the situation there the equivalent of “policy whack-a-mole.” He notes that as China resolves one issue, another pops up somewhere else—moving from property concerns in recent years to credit worries now. He is uneasy not just about the scale of China’s credit growth, but also its speed. “It is not quite the levels of Ireland during its bubble but it is approaching it. More recently, because they switch things on and off (in order to try to control speculation), what China is doing seems to be the main driver for the headline global level of asset purchases.”

However, the view of the world, and hence the global recovery, has become very U.S.-centric in Newton’s opinion, leaving few concerned about the state of China’s growing debt.

With all the added uncertainty this has created, the global real return team has maintained its defensive stance focused strongly on capital preservation. “Are the current levels of valuations justified? We don’t think so. If bond yields are low and the world is challenged on a number of fronts, it doesn’t make sense to me to keep paying more. We believe it is right to be patient and stand back.”

UNWARRANTED OPTIMISM?

Stewart favors high-quality equities over investment-grade debt, although within the latter he does like those that are asset-heavy. Credit is at one of its lowest-ever levels, although there is high government exposure as a result of hedging. Precious metals can act as a hedge if authorities get the inflation they appear to be seeking, Stewart concludes.