Growing trade barriers, China's increasing debt burden and a rising tide of populist politics are among the key challenges for investors in the coming year, according to managers from Newton Investment Management. For Brendan Mulhern, Newton global strategist, the political quarrels that brought Donald Trump to power and heralded a potential UK exit from the European experiment are part of a wider rejection of the status quo.

Against this broader backdrop, he says, Newton maintains a relatively downbeat assessment of the chances of improved global growth in the medium term "and so our view is that the forces involving the populist backlash are only going to grow."

He notes how at the start of the 1980s, the UK, France and the U.S. offered nuanced economic models which then, following the fall of the Soviet Union and the emergence of “third-way” politics, converged on a Keynesian consensus of 2% growth and high employment. Now, with the rise of populism, that policy consensus has been rejected.

“There’s been a backlash against globalization and against the free trade agenda based largely on recognition that the spoils of economic growth have not been shared equally by society. Meanwhile, in economic policy the move is increasingly towards fiscal stimulus. Established political parties, aware of the shift in mood, have been increasingly willing to co-opt ideas from other parts of the political spectrum for their own,” according to Mulhern.

Immigration is one focus, and Mulhern notes how European electorates have become increasingly anxious around this topic. Populist parties across the continent have started to reflect these anxieties in their policies, he says. Free trade is another focus and Donald Trump came to power threatening to impose a 35% tariff on goods from China. This means that while free trade has not gone into reverse, its progress has been checked, says Mulhern.
HEDGING AGAINST RISK

For Paul Brain, head of Newton’s fixed income team, the prospect of rising U.S. interest rates is one of the forces behind the end of a longstanding bull run in bonds. Nonetheless, he points to a range of factors that could still stymie the economic growth those interest rate rises are predicated on. Among them, he says, are high levels of leverage in China, political risk in the Eurozone, and the potential for a UK Brexit to suppress growth. Elsewhere, he notes how the U.S. recovery is “long in the tooth” even as companies remain highly leveraged. Further, he maintains that despite recent rhetoric in favor of fiscal stimulus—particularly in the U.S.—there is no guarantee of a boom in construction.

These potential headwinds mean bonds remain an essential tool for balancing against different types of risk, he says. “In our view, it’s not necessarily a bear market for bonds; it’s a value market. Inflation-linked bonds are just one example of how you can use fixed income to balance risk. Global bonds are another. At present, we’re shorting the U.S. and the UK but are long Germany, Australia and New Zealand. Another option is to look at the debt of companies that could benefit from construction projects as fiscal stimulus programs begin to take shape. Those who can use a currency overlay could also benefit.”

RESILIENCE IN EMERGING MARKETS?

Rob Marshall-Lee, head of Newton’s global emerging markets, offers a more pragmatic view, noting that although recent rhetoric on the U.S. presidential campaign trail has raised the prospect of increasing trade barriers, it is hard to envisage large-scale de-globalization overnight. “Think of how much sunken capital there is in current supply chains—” he says. “I find it difficult to see a situation where that whole supply chain gets repatriated to the U.S.”

By the same token, a wholesale rollback of flexible labor markets is unlikely, in Marshall-Lee’s view. “Immigration was one of the key issues in the UK referendum vote and it was also a factor in the U.S. elections,” he says. “But without those new people coming into the U.S. and the UK, the long-term economic growth picture for those countries is much weaker—on a par with Germany and Japan as they contend with aging populations.”

On the question of how a U.S. interest rate rise could affect emerging markets, Marshall-Lee notes emerging market currencies have largely sold off over the past five years, making them far more competitive.

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