Vista

Rowan Dartington

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The latest outlook on the investment world

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John Betteridge
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The outlook

I make no apology for the fact that this edition's Quarterly Outlook will focus very much on the UK political environment. With the advent and outcome of the Conservative Party leadership contest, the long-running Brexit saga looks to have entered a new and potentially decisive (or dangerous) phase. The ramifications and likely scenarios are discussed later. But we are able to do so because it's not too difficult to explain market moves in the rest of the world, which have been rather muted in the second quarter. Not that there hasn't been much going on – on the contrary, some developments have been extraordinary, but the two powerful influences upon market direction have, at least in respect of equity market behaviour, been largely offsetting.

On the one hand there has been the continuing deterioration of the economic indicators, both the coincident indicators (for example the Chinese economy growing at its slowest rate for many years) and the forward-looking indicators – of which the most telling have been the various Purchasing Managers Indices (PMIs) in most of the major economies. Some slowdown was of course inevitable, following the surge induced by US fiscal loosening last year, but the deterioration has been marked. In some cases, for instance Germany, this seems to presage outright recession. The IMF reduced its 2019 global GDP forecast in its April "World Economic Outlook" and has just reduced it further in its July update.

US/China trade dispute

Of course, what hasn't helped this perception is the escalation of the US/China trade dispute in May. That the US imposed 25% tariffs on $250bn of Chinese exports to the US is bad enough (and China retaliated with 20% tariffs on $110bn of US exports to China). But the fact that these were announced on Twitter at precisely the time of ongoing negotiations with the Chinese is not what one expects of serious negotiations conducted between economic superpowers. Markets sold off around this time. These tariffs are having an impact in Asia and also on some sectors of the US domestic economy, a point which the IMF has explicitly acknowledged. Of course, a truce of sorts was reached at the G20 meeting at the end of the quarter, but the concerning thing about these events is that it does reflect a struggle for economic hegemony which is not going to go away. This is one area of US policy where the Democrats are aligned with what Trump is trying to do.

However, although markets were shocked at the imposition of tariffs, they quickly jumped to the conclusion that there would be an offsetting policy response from the World's Central Banks. If you remember, last quarter saw an amazing reversal in sentiment about the future course of short-term interest rates, mostly in the US but also elsewhere. Expectations turned from a number of increases in short rates to rates being on hold or even being reduced. The second quarter continued the trend such that market participants began to expect two or even three reductions in interest rates in the US as the economic environment deteriorated. This shift was enough to drive bond yields, which are simply echoing the markets' views, down to levels last reached in 2016, such that, once again, a large proportion of global sovereign issuance is trading at negative yields.

Market sentiment

I've mentioned before that it is a good thing that market sentiment is reflected in surveys and, to an extent, in valuations that are "normal" (whatever that is nowadays). The whipsawing of markets reflects, above all, uncertainty about policymakers' priorities; the poor level of sentiment, I'd argue, reflects doubts about the effectiveness of policymaker actions going forward. There is no doubt that the World's Central Banks would like to move interest rates higher. They are obsessed by the notion that, in the event of renewed recession, they have very little firepower left to tackle it. But the periodic bouts of softness to which the economy is susceptible give them no confidence that they can do this. What they would dearly like, of course, is some degree of support from national fiscal policy. But the continuing high level of sovereign indebtedness seems effectively to preclude that. Markets see policymaking as a one-trick monetary pony and don't really like what they see.

Is there a no-deal Brexit ahead?

To put the UK into this backdrop offers very little comfort. I think a few things have changed since Mrs May resigned, besides the inevitable accession of Boris Johnson. First, we now have a

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Prime Minister who apparently is far more committed to a no-deal (ND) Brexit than she ever was. Secondly, there is a sense that the October 31st deadline is rather more of a drop-dead date than March 31st ever was, not least because of the attitude of hardliners in the EU. Third, the Labour party has shifted, meaningfully but not fully, towards supporting Remain.

The impact of these developments is to make the possibility of ND later this year higher than it was; I still think it most probable that it won't happen – because of the declared opposition in Parliament. But the fact that Boris has declared for Brexit "do or die" by that date does mean that even he would find it difficult to carry on and ask for an extension as May has done. Which means that some referral of the Brexit issue to the court of public opinion sooner rather than later becomes much more likely, be that a General Election or a Referendum. This implies that the stance of the Labour Party in that process becomes more important.

There are some fundamental questions for the Boris premiership to answer. Some people say (and hope) that the most important one of all is which of his promises does he choose to break? He has vowed to complete Brexit by the deadline, not to give way on the backstop, not to hold a Referendum nor to have an Election. At least one of these will have to go, not least because he's got one of the smallest majorities in history.

The one hope of delivering Brexit, I think, is if some very small amendments to the Backstop can be negotiated, then the PM might be able to get support for a slightly changed version of May's Withdrawal Agreement to go through Parliament, particularly if he can bring around some Labour Leavers. He might just be able to do this – after all, if he is so confident of implementing the technology eventually to implement Brexit without creating a hard border in Ireland, why not agree to the backstop in the full knowledge that its insurance policy will not be required.

However, if Labour really has become the Remainer party, then it should oppose this development and vote down the Government, while campaigning energetically for Remain in the following election. There is a distinct possibility that such a shift could persuade people to disregard some of the less salubrious aspects of the party, such as the heavily socialist agenda and its institutional anti-Semitism, particularly with an effective marketing campaign. For now, Corbyn is resisting the full extent of this shift to Remain. But there must be a good chance that he is persuaded (against the better judgement of his immediate advisers) and, if so, Labour becomes electable in its own right.

On the other hand, if an election were to happen soon and the political parties' platforms were to remain broadly unchanged, the only certainty would be that it would be an extraordinarily confused election. It is difficult to see how Tories such as Philip Hammond and Rory Stuart could fight on the same manifesto as Jacob Rees-Mogg. The only thing that unites them is fear of Corbyn. In which case, the Tory vote would be divided and decimated and the likely outcome would probably be a Labour/SNP/LibDem coalition. This may not be a bad outcome – it would probably not end the Brexit uncertainty, but might soften the more radical and extreme ideas of the Labour left.

But I do now think that the outcome of the ongoing Brexit debate is probably of less importance to markets than the composition of the Government that takes us through it. This is not an encouraging picture, not least because it points to continuing uncertainty and the possibility of binary outcomes. In these circumstances, the best investment policy is to stay cautious and well-diversified.

Past performance is not indicative of future performance.

Guy Stephens
TECHNICAL INVESTMENT DIRECTOR

Thinking long-term

Many investors will be familiar with the repeated advice that professional advisers provide with regard to thinking long-term. Investing is all about spotting trends and themes, then investing in companies and countries that stand to benefit over the longer term and letting this unfold. You have to be careful with these trends though. You never know whether you are getting in at the best time, so a gradual approach can sometimes be more beneficial in case you are buying at a peak of enthusiasm.

Long-term investment themes

Some themes are obvious. We expect that with an ageing population we will see a consequent increased demand for related spending, such as healthcare, but also discretionary consumer expenditure on leisure, such as cruises. Less obvious, however, is demand for financial advice as strategic pension planning becomes critical as we all spend much longer in retirement.
Other obvious themes can be found in the automotive industry. The transition from fossil fuelled transport to electric provides opportunities, but also the threats to incumbent vehicle manufacturers. The inclusion of artificially intelligent engineering and potentially self-driving, speed restricted vehicles threatens the performance car, but then opens up opportunity for the extensive hiring of cars for standard travelling, hence the ability of Uber to recently successfully float on the US stock exchange, despite being loss-making.

We should be wary when competing in a crowded marketplace

The latest successful round of financing for Tesla was based on a similar belief that they possess a product which will change all of our lives. However, this is where we must be careful, as those with a high profile today may not be the eventual winners. Twenty years ago, in May 1999, those old enough will remember the predictions of the internet revolution and the stratospheric valuations of dotcom businesses at the time. The last profitless flotation that promised to revolutionise discount retail was lastminute.com - an ironic title - and where are they today?

Actually, they are still going but competing in a crowded marketplace with the likes of Booking.com, Kayak, Trivago, Groupon and many others where low economic barriers to entry have competed away any first mover advantage they may have initially had.

At the same time, Yahoo was the internet search engine of choice with no hint of the future dominance of Google. The growth theme was the demand for internet search engines, so an open mind to the successful players was vital. This is the same today with electric cars. Battery charging technology defining range will be the key, with many combustion engine manufacturers pouring millions into development.

The same can be said of Purplebricks, which has shaken up the estate agency industry. Unfortunately, lots of secondary mover businesses have also set up, competing away the super-normal profits in the UK whilst Purplebricks were spending all that first mover profit on lossmaking overseas expansion. The CEO has gone, and investors are now regretting not selling when they had enjoyed a five-fold share price increase. The wonders of hindsight! Then there is the rise of Amazon and the demise of the high street – secular and irreversible trends.

The companies of today

Amongst the largest companies of today are Apple, Microsoft, Google, Netflix, Facebook and Amazon and we all know why. To illustrate their penetration into everyday life, I have used the first three of these in the preparation of this article.

Then there is the social media revolution involving Facebook and the like, with 'youtubing' now being an advertising career based upon followers and views, rather than paying subscribers, making millionaires out of teenagers. Additionally, we have witnessed the move into domestic TV-on-demand and box-set binging that we are all able to do, instead of making do with scheduled terrestrial TV. All of these are examples of technology-enabled consumer evolution and all have delivered investment opportunities and disturbed the incumbent status quo.

Looking to the future

Returning to the flotation of Uber, many have questioned how a loss-making business could attract a valuation of $82bn and have noted that the prospectus stated that the business may never make a profit. One clue is revealed by the fact that PayPal took a $500m stake. The key here is not what Uber achieves today, it is what it could become in the future with self-driving cars and a captive passenger who can be sold to whilst travelling. Investors, and

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PayPal, are obviously prepared to gamble on that future. If you have ever used Uber, you will be astounded at how convenient, quick and cheap it is. No need for cash, lots of availability and most convenient of all, they will pick you up from wherever you are. There are alternatives to Uber such as Lyft, but the former has first mover advantage and for the consumer, there are few downsides. And remember, Facebook was unprofitable when it floated with many sceptical commentators.

The same can be said of battery technology. The company that creates a rechargeable battery powerful enough that mobile phones will only need charging once a week, or enables electric cars to travel for as long as fossil fuelled cars, will be the largest company in the world. The same goes for artificial intelligence applications. Many of us will be familiar with the frustration of poor service from call-centres and being passed around a large organisation where no-one appears to be able to help or even want to. In time, artificial intelligence will provide this, but as we have seen tragically with Boeing, allowing the machine too much control can be catastrophic.

We wish we had the answers as to who will emerge victorious in each of these markets. Those that do will be the billionaires of the future. Observing all the security paranoia over Huawei at the moment, just imagine if China became the source of these inventions and not the US? In fact, electric car sales in China were twice that of the US in the year to the end of December 2018 (Source: Google, not Baidu, the Chinese equivalent). This is probably influenced by the availability of US oil reserves, population density and the US desire for gas-guzzling pick-ups. So, as Android enabled phones stop supplying US applications as part of the Huawei/trade negotiations, will China really care that much if they have their own alternative, with equivalent or better functionality?

Expanding outside the Western Economy

The US is feeling that its global dominance is under threat, having had it all its own way for so long. This is no bad thing and they should be the last to complain, being such advocates of free market competition and capitalism. However, that is probably only okay whilst they are the dominant player. We recall China quietly landing on the dark side of the moon in January, just after Trump had announced his planned space force for US domination. Observe how US Western allies, including the UK, are being careful not to aggressively join the anti-Huawei US assault, nor support the US aggression towards Iran. These are all potential allies of China (and Russia) and smaller nations need to be careful how they play their cards.

This influences investment as most equity portions of portfolios are significantly exposed to Western businesses. If the future technological revolution is going to come from the east, so much so that the West may subsequently be in decline, then we need to take heed. History is littered with the rise and fall of great empires.

Who will win the wealth of the future?

Clearly, the US is using any means at its disposal to protect its global monopoly on technological evolution and it has been accused by China of being a bully in the latest trade negotiations where intellectual property theft is a perceived stumbling block. We are all familiar with the demand from the east for our universities and fee-paying schools – this will be all part of the centrally controlled future strategy of the People's Republic of China. Regardless of your views on the political system, Western democracy is hardly covering itself in glory at the moment. Meanwhile, under the bonnet, there is a technological war going on which will define the winners and the wealth of the future. As investors, we need to keep a very close eye on this as the US plays hard ball with China. We have a second superpower in the making and the first is feeling threatened. The rise of the east is cause for concern, but also opportunity as we monitor asset allocation. Hopefully the power struggle will be peaceful but if we refer to history, that has been far from the case. Let's hope the human race has evolved somewhat so that we all benefit.

Donald Maxwell-Scott

TECHNICAL INVESTMENT MANAGER

How secure is your investment?

When it comes to investing, the security of our clients' assets is paramount. As with investing through any financial institution, it's important for clients to be aware of how their assets are safeguarded and what protections are available in the unlikely event of our firm going into administration. Understandably, clients want to know when they invest with Rowan Dartington, they are dealing with a company that will help protect their assets in the event of insolvency.

As a leading provider of specialist investment services, Rowan Dartington manages more than £2 billion of assets for private clients. Since 2016, we have been part of St. James's Place, one of the UK's largest wealth managers with over £109 billion under management and a listing on the FTSE 100 Index.

Rowan Dartington is regulated by the Financial Conduct Authority and we are therefore bound by their rules and regulations, in particular Client Asset (CASS) rules which govern how we look after and protect client money and assets.

Important measures to help protect your assets

We have established a series of controls and processes to make sure that all client assets are protected. These include:

Senior manager oversight: We have appointed a senior manager who is responsible for ensuring that all our clients' assets are protected. This person is approved by the FCA to hold this position.

Third-party due diligence: We take care in selecting and appointing any third-party firms we use to hold client assets and conduct formal due diligence on them at least once a year. If there are any concerns over the liquidity or performance of the organisations we work with, these providers will be reviewed, and appropriate action will be taken if required.

Reconciliations: We conduct regular reconciliations between our records and those held at third parties as prescribed under the FCA's CASS rules. If we identify any discrepancy or shortfall, we will investigate further and then resolve the issue by making up any difference if required.

Client-specific record: Our systems and controls ensure that at any time, and without undue delay, we can identify the assets we hold for each client.

CASS resolution pack: We keep an up-to-date CASS resolution pack as required under the FCA's CASS rules. This contains all the information required to assist an insolvency practitioner in a timely manner.

There are some other key protections at Rowan Dartington that clients should be aware of:

- We have permission to hold client money and investments (collectively known as 'client assets'), which we must protect on client's behalf. Notably, we cannot lend these assets to anyone else or use them to finance our own business.
- We take out insurance to protect our business against a number of risks. Where it is a regulatory requirement, or it is cost-effective to do so, we will typically have in place insurance to cover risks such as negligence, or our being defrauded.

What are the specific risks in relation to cash, shares and other investments?

All client money is held on trust and is segregated from our own funds in accordance with the CASS rules. This ensures any creditors

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of Rowan Dartington would have no legal right to it and we can not use this money to cover any of our own obligations.

The security of the banks that we use to hold client money is reviewed regularly. We monitor their performance and security on a regular basis and will take appropriate action if an issue is identified. Our policy is to only use institutions with a UK banking licence which are covered by the Financial Services Compensation Scheme (FSCS). For information on the scheme, please visit www.fscs.org.uk.

Shares you hold with Rowan Dartington are protected in our nominee accounts or by an approved third-party custodian with you named as beneficial owner.

In the unlikely event Rowan Dartington were to enter insolvency then clients would be able to transfer shares held in our nominee account to their new provider. If our administrators were unable to reconcile shares held in our nominee account with our detailed records, then again clients would be afforded some protections under the FSCS.

Funds such as Unit Trusts and OEICs use a trustee or depositary to hold the title to the underlying stocks they hold in their funds. This means if the fund manager gets into difficulty your assets are protected from their creditors. The exception to this may be where the domicile of the fund group is based overseas. Nevertheless, this does not mean the investor isn't protected; it is likely that investors in funds domiciled overseas will have protections in the funds home territory.

We understand that the security of assets is a primary concern of all our clients, and it can be complicated to fully understand all the different scenarios and implications. Should you have any queries then please contact us to discuss.

Please note, the very stringent measures we have in place are to protect investor assets, however, it does not protect investors against the risk of loss.

Further information

Rowan Dartington is also registered with HM Revenue & Customs. This enables us to act as an ISA manager, therefore, our procedures for operating an ISA are in line with rules set by HM Revenue and Customs.

Both Rowan Dartington and St. James's Place are separate entities, therefore, we are both independently regulated by the FCA with different registration numbers. Clients that hold assets with both companies will benefit for the protections available to them under the FSCS for both companies. Further information on the Financial Services Compensation Scheme can be obtained by visiting their website: www.fscs.org.uk

Clients can telephone the Financial Conduct Authority Consumer Help Line on 0800 111 6768 to check our registration, or alternatively you can visit www.fca.org.uk. Our registration number with the FCA is: 155241.

The value of an investment with Rowan Dartington may fall as well as rise. You may get back less than the amount invested.

Tim Cockerill

INVESTMENT DIRECTOR

ESG: The quiet revolution

> "Much of this may sound altruistic but there are solid financial reasons too."

The fund management industry is going through a quiet revolution. In the past two years investment groups have begun to embrace environmental, social, governance (ESG) in a major way. And although it's fair to say, this embrace is felt with less passion by some than others, it is nonetheless significant and long overdue.

So what is ESG?

ESG is perhaps best described as the impact a business has on the environment and society and the integrity of those managing it. The environmental impact can be looked at in two ways, from a negative perspective – and from a positive perspective, for example a manufacturer of energy efficient light bulbs has a positive impact by enabling a reduction in energy use and therefore lower CO2 emissions. An example of the societal impact would be safety in the work place or reducing the use of sugar in food products. A food business committed to reducing sugar levels in products would be viewed positively compared with one that isn't changing. Corporate governance, of course, is about the honesty of a company; bribery and corruption being two high profile areas of concern.

What prompts these changes?

This quiet revolution is happening because of public demand and government legislation globally. Wherever you look the world is facing massive environmental and social challenges, most of which have largely been ignored by Governments, business and the population despite the growing warning signs and evidence from science. Climate change has been talked about for more than fifty years; global temperatures have been rising steadily and even if all CO2 emissions stopped today, temperatures will continue to rise due to the lag in the warming impact. The population of the planet is circa 8bn and forecast to rise to 10bn by 2050*; the current population is already putting a huge strain on the environment; a report from Cambridge University** highlights some of the areas under major stress – marine fish capture, ocean acidification, water usage, energy use and tropical forest loss.

Investment groups seem to fall into two groups where ESG is concerned. The first simply see it as another risk to be aware of when making decisions. The second see the need for change and that the global economy is evolving into one driven by sustainability issues, and they want to be a part of that change.

These investment groups are embedding ESG into all their thinking and decision making. A key aspect of embracing ESG is engagement. This is where shareholders become proactive and seek change, using their influence to improve the ESG aspects of a business. Many shareholders (large and small) feel it is their responsibility to do this, and if the shareholder is substantial their influence is that much greater. The industry is also coming together around issues; collaboration adds weight, and the use of outside expertise in areas such as healthcare and the environment only adds further to the impact of their research and demand for change – recently there has been collaborative engagement to address the high levels of sugar in foods.

But, is this all financially viable?

Much of this may sound altruistic but there are solid financial reasons too – indeed it's unlikely an investment group would engage if there wasn't a financial gain involved. Businesses that are well managed, have a social mandate to operate and provide positive solutions will most likely be good investments. Indeed, it is increasing accepted that companies with good ESG records perform better than those that don't. A study by Friede & Busch collated over 2,000 academic studies from the past 40 years which examined the relationship between ESG factors and financial performance. In over 90% of them ESG factors were found to have a positive or neutral impact on financial returns. Essentially, those with good ESG records perform better.

But perhaps the biggest investment rational is that in addressing environmental and social challenges businesses are essentially achieving them through the delivery of critical services and products – and those that get it right stand a very good chance of providing investors with excellent long-term returns.

Source: * United Nations, August 2019 ** Rewiring the Economy (Cambridge University), November 2017

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