2016 – Issue 1

STUART + CARLYON

Financial advisers for your lifetime goals

Six signs of recession?

There's a definite doomsday mood accompanying Donald Trump's march towards the nomination as the Republican candidate for presidency. The world is aghast, and when you mix this malaise with the unnerving market headlines we have seen this year, the see-sawing share markets, the collapse in commodity prices, the negative interest rates in Europe and Japan, (not to mention the slowing growth rate of the China economy), well, is there any wonder that there are murmurs that we are on the brink of some global recession? Right now all news seems to be bad news.

It doesn't help if you Google "global recession" because you'll get 46 million results; all of them no-doubt disheartening. It's like getting a sniffle, consulting Dr Google, and ending up on a website devoted to some chronic terminal disease.

But is it all doom and gloom? At a recent briefing by fund manager Harbour Asset Management, their analysts boiled recession risk down to six indicators and then commented on where the US, China and NZ sit. The table below runs their six signs of recession past these three economies.

Indicators of recession

	US	NZ	China
Very early indicators			
Elevated debt levels and asset prices	Some de-leveraging	Elevated debt	Yes
Inflation pressures building	Yes, but from low base	No	No
Impending indicators			
Tight monetary conditions	First hike off low base	No	No
Tight credit conditions	Not really, ex-Energy	No	No
Almost real-time indicators			
Consumption and employment	No	No	No
Industrial production	Yes, less so ex-Energy	No	Slowing

As you can see, very few recession boxes are ticked. China has the one bad score, with elevated debt levels and excess housing assets. However, it has the wherewithal to contain any problems internally as it rebalances its economy from construction-led to consumption and services.

Global mining and energy companies are certainly struggling right now, and credit conditions for oil producers have tightened. Likewise their output has plunged which skews US industrial production figures. But strip out the energy sector and the outlook is actually benign. With consumption and employment firm, and interest rates and inflation low, global economic conditions remain sound, or at worst a little soft.

When share markets are priced as if recession is around the corner, the best strategy is to rebalance your portfolio, take advantage of the bargains and buy more shares while they are cheaper. Uncertainty can be uncomfortable but one thing we have noticed here at Stuart and Carlyon is that our long-term clients are more relaxed about the current jittery mood than are our clients who have just started.

As our seasoned clients are saying, "we've been through this before and it always comes right."

This confidence appears to be one of the so-called Seven signs of aging. (Sorry L'Oreal.)

We have said this before. Global economies, ultimately, are made up of billions of individuals who are each basically working hard to better themselves. Political movements come and go, commodity prices go through their cycles, but in the long-run, the world keeps moving forward.

How to keep your cool during uncertainty

Risk is a weird thing. Most of us understand that all investment comes with an element of risk, but the way our brains are wired, is not particularly useful when it comes to dealing with uncertain times. Conceptually we have no problem with the idea, but in reality there's a mental panic-switch that gets thrown the moment signs look bad. This is quite evident whenever the markets suffer a downturn.

In every case when we help clients put together an appropriate investment portfolio, we consider the risks. We already assume that share prices are going to vary. We already factor in the possibility of upswings and downturns. For new investors, the journey into negative territory is unnerving.

STUART + CARLYON

2016 - Issue 1

Here's a reminder of what we do to ensure that reasonable risks are taken account of.

- First, you make sure your portfolio matches your goals and needs. If you have limited resources, then your portfolio is designed to be more modest in ambition, and less exposed to risk. All portfolios are diversified whatever your circumstances.

- Second, we regularly rebalance or recalibrate your portfolio which is why we report to you six monthly. It can include making sure you remain on track with your retirement goals whether saving or drawing.

- Third, we hold our nerve. When things turn down it can be too tempting to new investors to quickly sell out. Experience shows us that so long as the things we have invested in are fundamentally sound, then when their share prices go down, rather than sell it may be more appropriate to buy while their shares are less expensive. The old moral of the story is buy low, sell high.

- Fourth, we distinguish between trends and the day-to-day noise of the share markets. New investors often pay daily attention - or even hourly attention thanks to the Internet - to the shifting values of their investments. Airport shares are up by ten cents! Industrial shares have dropped 35 points! What we find is that over time this kind of daily noise is fundamentally irrelevant. It is static or white noise and not worth getting too worried about. If your house dropped in value by $60,000 today, would you suddenly put it on the market? We doubt it.

One of the benefits of a well-managed portfolio is that the choice of investments is designed so that you can sleep well at night. Products and services that people fundamentally need and want, are going to do just fine.

Book review:

Red Notice by Bill Browder

Who would have thought that a tale of fiduciary due diligence - a story by a hedge fund manager - would read as thrillingly as a Dan Brown airport novel?

Bill Browder is a bright player in the financial sector who in 1996 saw big opportunities for Western investors in Russia. At the time, state run enterprises were being put on the market, and most were hugely underpriced.

Hugely, by as much as 1,200%. Browder established an investment fund, the Hermitage Fund which by 1997 had parlayed $25 million into a fund worth more than $1 billion. In 1997 the Hermitage fund was ranked the best performing fund in the entire world. What could possibly go wrong?

Well, just about everything. Local oligarchs in Moscow didn't like this interloper, and they systematically - with the help of the secret police - started shutting down the fund management operation first by using trumped up charges, and secondly by manipulating the courts to transfer the ownership of the funds to shell companies owned by the Russians themselves.

Staff were arrested. The company lawyer was kidnapped and tortured. And all the while Bill Browder started fighting back, using the court of international opinion to shame the Putin government.

Browder's book is an absolute page turner, and gives an insight into an economy and a political system that is rife with corruption. One can't help feeling that the victories that Browder eventually won, were Pyrrhic in nature, and that corruption in the Soviet economy remains unfettered.

Red Notice. Bill Browder. Simon & Schuster 2015.

155 Parnell Road, PO Box 137-154, Parnell, Auckland 1151, New Zealand Phone: 64 9 307 2331 Fax: 64 9 307 2330 www.stuartcarlyon.co.nz