

Monthly Commentary

For professional investors only

It would be pleasing to see a month go by without a terrorist atrocity somewhere in the world but, sadly, May was not going to be one of those months. The Manchester abomination is just one more in a string of similar attacks. It is difficult for the authorities anywhere to protect citizens from extremists who operate alone, wear no uniform and are prepared to die for their beliefs. There will, undoubtedly, be many more unhappy months.

Donald Trump embarked on his first overseas foray since becoming president and romped through several countries and many meetings in the Middle East and Europe in little more than a week. It is doubtful that any other US leader has courted such controversy. Not noted for his conciliatory approach (to almost any subject), he has been climbing a steep learning curve on matters foreign. He has, no doubt, raised the level of anxiety amongst some of the old hands and many of the new at the international table. Of course "The Donald" believes his trip was little short of a triumph.

The US stock market has continued to perform relatively well as we enter Mr Trump's fifth month in office although there are increasing mutterings about his ability to deliver on his pro-growth agenda. There is sound reason to agree with the "mutterings" as Mr Trump is discovering that being president of the world's largest economic entity within a parliamentary system is rather different from heading a large corporate or hosting a television game show. It will be an interesting four years.

France resolved its presidency issue on 07 May with a resounding victory for 39 year-old Emmanuel Macron over the far-right candidate Marine Le Pen. Ms Le Pen won just 34% of the vote although such a total is not to be sneered at too loudly given that the two major political parties were comprehensively vanquished in round one of the voting on 23 April. Le Pen has achieved the most significant level of support for the far-right since WW2.

Ms Le Pen has, reportedly, now abandoned her campaign policy to leave the EU and restore the French franc. It is likely that these proposals were simply too extreme for the majority of the voters. It is now 18 years since the franc was abandoned but it is clear that the euro issue continues to rattle the election cages. Presumably 34% of the French voting public were prepared to dump it - not an insignificant number. A Federal Europe, the only way the euro will ever work, seems as remote a possibility as ever. It is inevitable it will continue as a divisive political issue.

There is much tough work ahead for Mr Macron - although he first must endeavour to win a majority of seats in June's parliamentary elections (held on June 11 and 18). His *En Marche!* Party has only been in existence for a year and the outcome is difficult to predict. Mr Macron's predecessor (Francois Hollande) failed to tackle any of France's fundamental problems so in a sense any action can be regarded as progress. The French public sector accounts for over 50% of the economy so we will reserve any cheering until



Mr Macron starts to wind back the footprint of the State whilst eliminating legislation preserving the ludicrous 35 hour working week.

In Germany, Mrs Merkel's position has strengthened following a significant defeat of the leader of the *Social Democrats (SPD)*, Martin Schulz, in his home region of North Rhine-Westphalia - until now a stronghold of the *SPD*. Mrs Merkel's Christian Democratic Union secured 33% of the vote - four points ahead of the *SPD*. Mr Schulz is the former president of the European Parliament and has only been leading the *SPD* since March. His initial support was very strong so this latest result is significant in the light of the Federal elections due in September - Mrs Merkel now seems assured of winning her fourth mandate.

Meanwhile the European Central Bank has reaffirmed its intent to keep the monetary stimulus rolling - at least for the time being. The bank is buying €60 billion **a month** of government bonds and has maintained its key deposit rate at -0.4%. Mario Draghi, ECB president, stated that underlying inflation was still too weak to justify a change in policy. Here are the facts: as at the end of April the eurozone average inflation rate was 1.9% whilst Estonia, Lithuania and Latvia all experienced annual inflation rates in excess of 3%. The rate of inflation in eleven of the nineteen eurozone countries was at or above the ECB's target of 2%. The lowest rate in the "zone" was Ireland at 0.7%. Somehow, none of this seems too "weak" to our befuddled brains.

In the UK the election campaign is in full swing and the Labour opposition has substantially narrowed the lead of the Conservative party but this is typical of mid-campaign polling. It still appears likely that Mrs May will win this battle. The 'Brexit' negotiations can then begin in earnest.

In Australia the latest Federal budget was introduced and it included a new and surprise tax on the country's major banks. The tax is to be levied on the liabilities of the banks at a rate of 0.06% and is budgeted to raise \$A6.2 billion over four years (although the calculation is disputed). Needless to say the bank share prices dived following the announcement.

The Aussie budget deficit is widening - in contrast to most in the world - and this new tax is intended as part of the "budget repair" process. Funny, we hadn't realised that the banks were to blame for Australia's budget deficits. You live and learn.

Apple hit the financial headlines (again) in May when its market capitalisation passed \$US800 billion - a first for a US company. A decade ago capitalisation was under \$US100 billion. The 10th anniversary *iPhone* is released later this year and it appears anticipation of this event is feeding investor juices. Even Warren Buffett has taken a bite. *Apple* has always managed to confound so we will refrain from any forecasts - usually a parlous practice with any technology stock - particularly one that is at the "fashion" end of the market. Warren Buffett isn't always right, but his average "win" ratio isn't too shabby.

A massive cyber-attack in May (WannaCry) knocked out a third of Britain's National Health Service and disrupted scores of major businesses. Threats of more to come have been made. The murky world of the "dark web" (apparently many times larger than the visible web), is where nefarious groups get together to discuss their evil plans and share cyber weapons. In recent days British Airways suffered a power outage which somehow managed to shut down their entire fleet - over a bank holiday weekend! Whether this is more of the evil plottings of the dark web remains to be seen. What it does highlight is that this interconnected world is now battling a totally new kind of criminal and disrupter. Ironically, the hacking tools being utilised for illegal purposes were often developed by governments and subsequently stolen. A few lines of code can destroy a business. The "good guys" are going to have to run very fast to stay abreast of this scary game.

With few exceptions the world's equity indices continued to climb in May. Expressed in US dollars the MSCI World price index advanced by 1.78% whilst EAFE moved ahead by a more substantial 3.07%. In MSCI **local** currency price terms the EU was up 1.83%, Eurozone 0.31%, Far East 2.18%, G7 1.25%, Nordic countries 1.79%. North America 0.96% and Pacific



0.84%.

At the country level, again utilising MSCI local currency price indices, Austria excelled with a gain of 4.36%, hotly followed by the UK with 4.29%. Other impressive advances were Finland 3.47%, Portugal 2.84%, Denmark 2.79%, Hong Kong 2.65%, Norway 2.32% and Switzerland 2.08%. The US squeezed out a gain of 1.1% but Canada disappointed with a negative 1.59%. Bottom of the heap was Australia with a negative index return of 4.19%. If you clobber the banks you clobber the Aussie share index – simple maths.

If we cast our gaze out to ten year annualised returns (MSCI local price indices) it is interesting that only three developed markets have achieved returns of 4% or better – Denmark, the US and Hong Kong – with 6.91%, 4.44% and 4.0% respectively. The bulk of the developed markets have achieved negative annualised price returns. The top three in the **negative** column are Portugal (-9.91%), Ireland (-8.87%) and Austria (-8.39%).

It is interesting to note that Portugal and Austria were two of the top performers in the latest month. A long-term perspective is always more than useful!

And in case you are wondering why Greece managed to miss out on one of the top negative spots over ten years we would remind you it is classified by MSCI as an emerging market. For those interested it managed an annualised negative of 28.11%. No other emerging market came even close to that spectacularly disappointing performance.

Government bond markets were relatively subdued although the general trend at the ten-year maturity was for a slight decline in yields. We saw, for example, falling yields in the US, Canada, Australia, Germany, France and the UK. In many countries the rate of inflation is now comfortably above ten-year yields. Something has to change.

Pyrford International

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Enquiries:

Pyrford International Ltd - 95 Wigmore Street, London, W1U 1FD, United Kingdom
+44 (0) 20 7495 4641 | information@pyrford.co.uk | www.pyrford.co.uk

Pyrford reference: 1512017