Select Wealth Management

Sophisticated investing made easy

# Investment Update – August 2016

*Prepared by JMIS, investment consultant to Select Wealth Management*

The Brexit vote has long term implications beyond the UK and Europe. The vote in the UK is probably part of a wider, more global backlash against the establishment, rising inequality and globalisation. The Brexit shock may well intensify the pressure on all governments to better address inequality, become more protectionist and limit migration.

More particularly, investors may now have to factor in a higher chance of low interest rates for longer and even lower global economic growth, the latter possibly arising from the increasing ineffectiveness of monetary policies, trade barriers or a move (through taxation and regulation) to redistribute income from capital to labour. The Brexit vote has heightened expectations that central banks will now cut interest rates in England, Japan, Australia and the euro area.

**US**

The economy grew by an annualised 1.1% in the first quarter, according to a revised estimate. This was better than the initial 0.8% recorded in the first estimate, but still the slowest pace for a year.

Non-farm employment rose very strongly in June to 287,000, well above the downwardly-revised 11,000 in May. This was the strongest month of hiring since October 2015. Unemployment now stands at 4.9%.

With a falling euro and UK pound after Brexit, a significant strengthening of the US dollar would be not only a problem for US growth prospects but also for the dollar debtors in emerging markets. It could also push commodity prices lower.

**Japan**

In late July, the Bank of Japan announced additional measures to stimulate growth but it refrained from taking its negative interest rates deeper nor expanding its government stock purchasing programme.

**China**

China's economy grew 6.7% in the second quarter from a year earlier, slightly better than expected. While fears of a hard landing have eased, investors fear a further slowdown would leave the world even more vulnerable to the risk of a global recession.

Brexit may bring policymakers in China further challenges in managing their slowing economy, i.e. how to manage the yuan with all the major currencies, except the US dollar and the Japanese yen, now falling in value. China stands to lose one of its strongest allies in the EU trade bloc and, with falling exports, it can ill afford any significant slowdown in European demand or global investor sentiment. It will renew its vigilance for any hot money flows out of China. Any large devaluation of the yuan would intensify global growth and deflation concerns.

**Europe**

After Brexit, there is likely to be considerably lower growth in the UK and continental Europe. Central banks are set to ease policy in both economies.

**Australia**

In July, the RBA left the official cash rate unchanged at 1.75%, but a combination of a strong Australian dollar and low inflation may well prompt a cut in official rates in August. Weak wage growth, global disinflation and evidence of retail discounting are all contributing to the low inflation.

In the recent general election, the Liberal party gained power with only a very small majority in the lower house but were left with an even more disparate and fractious Senate than before the election.

**New Zealand**

In late July, the Reserve Bank advised that:

*Prospects for growth in the global economy have diminished despite very stimulatory monetary policy and low oil prices. Significant downside risks remain. Financial market volatility increased following the UK referendum and long-term interest rates have fallen.*

*Domestic growth is expected to remain supported by strong inward migration, construction activity, tourism, and accommodative monetary policy. However, low dairy prices are depressing incomes in the dairy sector and weighing on farm spending and investment.*

*There continue to be many uncertainties around the outlook. Internationally, these relate to the prospects for global growth and commodity prices, the fragility of global financial markets, and political risks. Domestic uncertainties relate to inflation expectations and the potential for continued high net immigration, ongoing pressures in the housing market, and the high New Zealand dollar exchange rate.*

*The trade-weighted exchange rate is 6% higher than assumed in the June Statement, and is notably higher than in the alternative scenario presented in that Statement. The high exchange rate is adding further pressure to the dairy and manufacturing sectors and, together with weak global inflation, is holding down tradable goods inflation. This makes it difficult for the Bank to meet its inflation objective. A decline in the exchange rate is needed.*

*House price inflation remains excessive and has become more broad-based across the regions, adding to concerns about financial stability. The Bank is currently consulting on stronger macro-prudential measures aimed at mitigating risks to financial stability from the current boom in house prices.*

*Annual CPI inflation was 0.4% in the year to June 2016. Headline inflation is being held below the target band by continuing negative tradables inflation. Long-term inflation expectations are well-anchored at 2%, but short-term inflation expectations remain low.*

*Despite rising capacity pressures and some recent increase in fuel prices, the stronger exchange rate implies that the outlook for inflation has weakened since the June Statement.*

*Monetary policy will continue to be accommodative. At this stage, it seems likely that further policy easing will be required to ensure that future average inflation settles near the middle of the target range. We will continue to watch closely the emerging economic data.*

**Summary**

We continue to expect a capital markets back-drop of low economic growth, low inflation and very low interest rates. We also expect the "high-yield" markets like New Zealand and Australia to be well supported by capital flows from the ultra-low monetary policy countries.