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Courtville Partners – Investment Outlook, April 2019

Summary of the key points in this quarter's Investment Outlook

- We expect markets in general to remain volatile in 2019.
- Most stock markets are still well below their end-2017 levels (with the notable exception of the US).
- Armed with a relatively high cash in our model portfolio, we are looking to buy when the market dips rather than sell when it rallies.
- The Fed has changed the direction of US monetary policy. "Don't fight the Fed," as the market maxim goes - which should mean that equities (and other assets) rise further.
- Time-limited bungs from the ECB to Eurozone banks cannot fix the structural faults in the single currency.
- Keep an eye on Italian politics: Italy is a much bigger threat to the euro – to the EU, even – than Brexit.
- UK equities look historically cheap on almost all valuation criteria. We suspect that markets have priced in a messy Brexit. Corbyn as PM, though, would be calamitous. Conversely, expect the value of UK assets to jump if the Corbyn risk recedes.

We have insisted often that we cannot forecast the short-term direction of markets. Nevertheless, we must confess to feeling disappointed by our failure to follow up the prediction of 4Q18's substantial stock market correction with an equally prescient recommendation to take advantage of the lower prices on offer early in 2019. But we didn't – and instead have seen almost every major asset class rally since New Year (global equities +12%, global bonds +2%, global property/REITs +15%, gold +1%). At the end of 2018 global equities were nearly 20% below their February 2018 peak. With hindsight, we missed a gaping opportunity to "buy the dip". Then again, most stock markets are still well below their end-2017 levels (with the notable exception of the US, which is up 5%). As always, it depends where the graph starts.

It is one thing to be wrong. But at least we know what it was that took us by surprise and, in the process, stoked the recent sharp recovery in both equity and bond values: the US Federal Reserve's dramatic change of monetary course at the end of January. Instead of bracing themselves for several more interest rate rises in the US, investors suddenly had reason to believe that the Fed would not tolerate further sharp falls in asset prices. This strikes us as a momentous shift of policy. Not only has the Fed at a stroke abandoned its longstanding and carefully curated plan to increase US interest rates at a steady pace for several years; but it also suggests strongly that the US central bank has added a third leg to its so-called "dual mandate" (which confusingly already takes in three distinct aims). As well as promoting maximum employment, stable prices and stable long-term interest rates, the Fed has given the distinct impression – albeit by its actions rather than words – that the sort of stock market sell-off seen in 4Q18 will no longer be tolerated (or at least will not go unchallenged by the monetary authorities).

Whether the Fed's Governor, Jerome Powell, has caved in to political pressure from the President matters less than the *de facto* revival of the infamous "Greenspan put". Named after veteran Fed Governor Alan Greenspan, this was a widely used term for the belief among investors that the US central bank would prop up financial markets with looser monetary policy (i.e. lower interest rates)

as and when required. If we are right that the "Powell put" is now in operation, then investors once again face a sick-making dilemma: even if fundamental factors such as economic growth, corporate profits and asset valuations seem less than attractive, should investors just hold their noses and keep investing (or at least keep invested) in the expectation that the committee that sets the most important price in the world will rig the market if asset prices fall too much? Must investors now heed the ancient maxim (often attributed to Keynes) that "the market can remain irrational longer than you and I can remain solvent", just as they did for much of the period from 1987 to 2008? Does that make you feel just a bit queasy? It probably should. Looking on the bright side, the Fed's interest rate U-turn is one reason why the recent inversion of the US yield curve (i.e. short rates are now higher than long rates) may well buck history by not presaging a recession. It also offers comfort that the 10-year bull market can endure for a while yet, albeit at the cost of some nose-holding by investors.

Why do we spend so much time thinking and writing about monetary policy – the management of economies via interest rates – when investable assets are our thing? That's a decent question. The philosophical answer is straightforward: price-fixing for the last 11 years (and counting) by central banks via quantitative easing ("QE") has mostly trumped all other investment considerations. But QE is now finished almost everywhere, bar Japan. The Federal Reserve had gone further in reversing the effects of QE than any of its counterparts in other regions, notably the European Central Bank and the Bank of England – which is another reason why the Fed's *volte-face* is so seismic. If the Fed felt forced to abandon Quantitative Tightening early, what price the others? The Bank of England may (and does) plead Brexit to justify clinging to its corrosively inappropriate interest rate policy. The ECB, however, is in an altogether trickier position. It brought its QE programme to an official halt in December, but quickly had to face the challenge of how to prop up European banks. Notwithstanding the onset of recession in parts of the Eurozone (notably in Italy), the end of QE has automatically tightened monetary policy, which in turn has started to squeeze net interest margins across the region's already enfeebled banking system. In response, the ECB has hinted heavily that it will shore up bank balance sheets with TLTRO3 (which stands for Targeted Longer-Term Refinancing Operations, part 3), i.e. a third round of bumper "cash-back" loans to banks in exchange for promises to lend the money on to the real economy (to companies, most obviously). This would avoid the cliff-edge effect of the 2017-vintage TLTRO2 maturing in summer 2020, most of which was taken up – surprise, surprise – by Italian and Spanish banks.

Time-limited bungs from the ECB to Eurozone banks cannot mend the structural faults in the single currency. As we have said before, what keeps Messrs Junker and Tusk awake at night is not Brexit, but Italy. At €310bn or thereabouts, Greece's bail-out ranks as a mere trifle compared with the size of Italy's government bond market, which is worth more than €2trn. If Italy's government one day asks the question "Who rules Italy, Rome or Brussels?", the European Commission may not like the answer. With Prime Minister Salvini's party, the Lega Nord, now winning all over the country (most recently as far south as Basilicata), that day may be closer than the consensus thinks. If Italy causes the euro finally to collapse, the scale of the financial and economic dislocation – to say nothing of the political fall-out – will be greater than anything our generation has seen. So investors should keep half an eye on Italian politics.

And if by now you are bored stiff by our musings on monetary policy, please allow us to flag one final nightmare-in-waiting: Modern Monetary Theory (or "MMT"), which is being espoused with ever greater enthusiasm by left-wing politicians everywhere as an answer to the genuine problems afflicting the capitalist system. Alas, MMT is not modern, is based on a fundamental

misunderstanding of what money is – and is not even a plausible theory (as Gavekal Research have pointed out, among others). Instead, MMT provides a veneer of intellectual respectability to the idea of the "magic money tree" (shorthand for the idea that governments can create as much money as they like without incurring nasty consequences in due course); but it doesn't make the magic money tree any less fantastical. Every time we hear MMT mentioned, we should all think about adding a bit more gold to our portfolios.

Amid all this monetary noise, what should investors be doing? We stand by what we said three months ago: we would be surprised if by the end of 2019 we had not advised clients to buy more equities. Valuations in most markets range between no worse/better than historical averages through to downright cheap. The UK is an example of the latter: the FT All Share Index stands well below historic averages on almost every credible valuation measure. It may feel uncomfortable to ignore both the Brexit pantomime and the (much more serious) threat posed by Corbyn/McDonnell's plans for a Marxist makeover of the British economy. On the other hand, real assets – including equities – should be a decent defence against the monetary madness of Momentum.

And talking of Communism… The risk/reward outlook looks quite decent again in Emerging Markets – especially in the Maoist-capitalist hybrid that is China. Chinese equities are still 15% below their 2015 peak; and global investors are still underweight as far as we can tell. If the change of direction in US monetary policy (and maybe slower growth) result in US dollar weakness, this should also help EM assets.

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Asset Classes	Courtville Partners Asset Allocation (%)	FTSE PI Balanced Index (%)
UK Equities	20	18.3
International Equities	42	39.7
Fixed Income	15	22.6
Alternatives	8	10.4
Commercial Property	4	0.6
Cash	11	8.4
Total	**100**	**100**

Courtville Partners Model Portfolio	ETF	Weight (%)	Changes this quarter	Weighted OMC
UK Equities		**20**	**+3**	
UK	VUKE LN	9	+1	0.09
UK	VMID LN	11	+2	0.10
International Equities		**42**	**+1**	
US	VUSA LN	6	-1	0.07
	XDPG LN	11	+3	0.30
Euro	VERX LN	4	-1	0.12
Japan	VJPN LN	6	-1	0.19
Asia	VAPX LN	6	0	0.22
Emerging Markets	VFEM LN	9	+1	0.25
Fixed Income		**15**	**-2**	
Government Bonds				
UK	IGLS LN	4	0	0.20
US	IBTS LN	3	-2	0.20
Index Linked Gilts	INXG LN	3	0	0.25
EM	JPEA LN	3	0	0.40
Corporate Bonds				
US	CORP LN	2	0	0.12
Alternatives		**8**	**0**	
Gold	PHAU LN	3	0	0.25
Infrastructure	3IN	2	0	1.48
Agribusiness	SPAG LN	1.5	0	0.55
Water	IH20 LN	1.5	0	0.65
Commercial Property		**4**	**0**	
Europe	IPRP LN	2	0	0.40
Asia	IFAS US	2	0	0.48
Cash	GBP	**11**	**-2**	
Total		**100**		**0.22%**

Courtville Partners	Model Portfolio	FTSE PI Balanced Index	Relative performance
2019 YTD	6.30%	5.66%	0.64%
Last 12 months	5.20%	6.75%	-1.55%
Since inception(1/1/2015)	37.93%	35.44%	2.49%
CAGR	7.87%		