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Courtville Partners – Investment Outlook, January 2020

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

- US equities have been the best performing mainstream asset class again in 2019, as they have for most of the last decade.
- Since the financial crisis of 2008-09, returns from US equities have eclipsed those of other risk assets – and to a staggering degree.
- Will this continue? We are not so sure and see signs that the hegemony of US equities may be coming to an end. Much will ride on the direction of the US dollar, which may finally be due for a correction.
- We think global equities still offer better returns than other asset classes but prefer to play this through non-US markets.
- Corbynista Marxism was always a bigger threat than Brexit; and UK equities look relatively attractive on valuation grounds. Sterling will probably remain volatile as a function of the government's self-imposed (and ambitious) 2020 year-end deadline to negotiate an EU trade deal.

The end-of-year stimulus to reflection gets an extra boost from the coincident end of the decade. How were the twenty-teens for you? For stock markets they were by and large spectacular, led by the daddy of them all, Wall Street, where the broad S&P500 Index now stands a whopping 378% higher than it did at its post-crisis nadir in March 2009. That represents a return to investors of over 15% per annum on average. Against a backdrop of abnormally low inflation, such rates of real (i.e. inflation-adjusted) return are eye-popping by any historical standard – and have provided colossal rewards for those investors who foresaw the rise to dominance of Apple, Google, Facebook, Amazon and their ilk. For all the fashionable talk of the US passing the economic baton to China, Uncle Sam has continued to dominate the world of equity investment since Capitalism's near-death experience of 2008-09. The obvious question is whether this long trend can endure – and, if so, for how long. We will come back to this shortly.

In case you need further convincing that the decade now ending has belonged to the US among major markets, compare that 15% average annual return with achievements elsewhere. In Europe, the Euro Stoxx 50 has risen at less than half the S&P500's annual rate (7% in euros and just 6% in dollars), while here in the UK the FT All Share Index has done only marginally better (8% in sterling, even less in dollars). The only major market to give the US a run for its money over the last 10 years has been Japan – an investor's graveyard over the preceding 20 years – where the Nikkei Index has compounded at an impressive 12% per annum in Yen. What about China's economic miracle? Equities there have compounded at a relatively modest 4.5% p.a. This happens to be only a little better than the average annual returns from US Treasury bonds (4.2%) – which in itself is a reminder that over the course of the decade now ending equities almost everywhere have trounced bonds, notwithstanding the monumental bull market in government-issued paper.

2019 was not an exception to the twenty-teens rule: once again US equities romped home in first place, rising a whopping 29% in dollar terms, and were the main driver of a 25% return for global equity markets (as measured by the MSCI World Index). As for so long, most non-US asset managers have been condemned to underperformance by their failure to allocate even an index weighting to the US, let alone an overweight position. More surprising, given the political

and economic travails of Continental Europe, the Euro Stoxx 50 ended the year not too far adrift of the US, returning 22% in dollars.

And talking of Germany… We considered three issues in our October Outlook that bear re-visiting, namely German fiscal policy, the allure of UK assets and the chances of a worldwide economic slowdown. All three remain pertinent; but Germany's fiscal potential still feels to us like the biggest game-changer at some point in the future. From one angle, nothing much has changed in German politics (or policy) over the last quarter. You will still get long odds on a premature collapse of the SPD/CDU-CSU *GroKo* (Grand Coalition) – for the good reason that all the Coalition's members have much to lose at an election, albeit for different reasons. So the installation at the top of the left-wing SPD of a pair of fiscal spendthrifts should not be taken as near-term encouragement for more government spending. Besides, Olaf Scholz is still firmly in place as Finance Minister; and the constitutionally enshrined principle of "*schwarze Null*" will be abandoned over his dead body. (Germany aims to run a federal budget surplus equivalent to 0.75% of GDP this year, which is as forceful a repudiation of Keynes as you will ever find.) More interesting – and worthier of monitoring – is the rise and rise of the Greens. Longer established as a political force in Germany than anywhere else in Europe, they already operate as the *de facto* opposition. But, with current levels of support putting the SPD in fourth place among the major parties, the Greens are now seen as the most likely powerbrokers of whatever government emerges from the 2021 general election. Add to the mix the dieselgate-induced heart-attack suffered by the country's totemic car industry and you easily set the scene for a loosening of the country's fiscal purse-strings in the medium term. As we argued last time, the sheer scale of the German economy offers the next administration spending firepower about which the rest of Europe can only fantasise.

The greening of Europe, however, is not a one-way bet for investors. We see a real risk of a de-carbonisation supply shock if the EU once more lets ideology trump economics. The form book suggests this is likely. The European Commission may have declared its lofty aim to make Europe carbon-neutral (however defined) by 2050. But Ms von der Leyen (Jean-Claude Juncker's replacement) knows very well that the Commission's macroeconomic influence is vested mainly in its power to regulate. By contrast, actual investments will for the most part have to be made by national governments. Do you see how all roads lead to German fiscal policy? In the absence of European governments earmarking billions – trillions, even – to de-carbonise their economies, the EU faces the danger of draconian regulation without any offsetting investment.

Meanwhile, on this side of the Channel the UK stock market is indeed looking more investible now that the spectre of Marxist confiscation has been banished for five years at least. To repeat ourselves: UK equities are modestly valued and stand close to the bottom of their 30-year range, even after the post-election bounce. Although it is now clear that the UK will leave the EU, the new government's self-imposed end-2020 deadline for agreeing a trade deal will probably trigger further bouts of nervousness in the coming months, which will in turn be reflected in the exchange rate. (We still struggle to summon much enthusiasm for sterling in light of the country's yawning deficits on its trade and current accounts, never mind the political inevitability of looser fiscal policy.) On the other hand, faced with the certain departure of its largest single trading partner, even the EU's brinkmen may choose to modify their behaviour and strike a reasonable trade agreement.

The third issue we flagged back in the Autumn was the risk of an imminent economic slowdown across the world; and this too seems to have been resolved in favour of equity investors. Factory purchasing manager index (PMI) data show signs of recovery almost everywhere after spending most of 2019 in decline; and recent data, not least on employment, suggest that the US economy in particular is in better shape than for some time. We shall never know whether (or how much) this owes to the Federal Reserve's decision to throw monetary policy into reverse and cut interest rates; but it doesn't matter now. Synchronised macroeconomic data echo – and may even be the results of – the coincidence of looser monetary policy in all the world's major economic blocs. And this is one of the main factors underpinning our belief that global equities can indeed continue their upward path, at least for now, albeit at a more modest pace after the string gains last year.

Will US equities go on doing better than other major markets? Here we are less sure, but incline to the view that Wall Street's long record of outperformance may be drawing to a close. Within the stock market itself, cracks are beginning to appear. For example, half of the stocks that make up the S&P500 are already 10% or more below their recent highs; and more than 60% of small capitalisation stocks stand 20% or more below their recent highs, possibly reflecting a 26% fall in trailing 12-month earnings. Much depends on the level of the US dollar; and there are several reasons to think that five years of relative strength for the US currency may be coming to an end, which would in turn probably bring down the curtain on the US stock market's outperformance.

First, US monetary policy is become materially looser, both by dint of the Fed's recent rate cuts and money-printing at a faster rate than any other central bank. Second, the US continues to run substantial deficits both on its current account and its federal budget. Third, President Trump's so-called "Phase One" deal with China has defused trade tensions for the time being and, in the process, may well have put a floor under both the Renminbi and other Asian currencies. Fourth, any improvement in the odds of Elizabeth Warren winning the Democratic nomination is likely to sap the dollar's strength (though impeachment has given Trump's re-election hopes a big boost). We may safely assume that a Warren presidency would bring stiffer regulation of Wall Street, higher taxes for wealthy investors and something resembling the European Commission's green agenda, all of which would bode ill for risk assets in aggregate. And, finally, whoever is in the White House, Big Tech has not escaped regulatory attack. It feels more like a question of when, not whether, the patience of lawmakers and regulators will be exhausted by technology companies' underhand use of personal data.

Finally, our model portfolio (as in the table below) has had another decent year, outperforming the FTSE Russell Private Investor Balanced Index by 1.3%. Over its five-year life the model portfolio has generated average annual returns of +9.3%, which is 1.6% per annum more than the benchmark. The 2019 outperformance mainly owes to the highest-level call of all, namely our decision to stay overweight equities and underweight fixed income. The portfolio would have done even better if we had invested more in US equities, kept less cash and hedged the strength of sterling (which appreciated 3% against the US dollar, denting the overall return by 0.35%). For now we are sticking to our guns as 2020 begins, i.e. we remain overweight equities, particularly non-US equities, and significantly underweight fixed income.

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Asset Classes	Courtville Partners Asset Allocation (%)	FTSE PI Balanced Index (%)
UK Equities	22	19.1
International Equities	46	40.8
Fixed Income	12	22.5
Alternatives	9	9.1
Commercial Property	3	0.5
Cash	8	8.00
Total	**100**	**100**

Courtville Partners Model Portfolio	ETF	Weight (%)	Changes this quarter	Weighted OMC
UK Equities		**22**	**1**	
UK	VUKE LN	11	+1	0.09
UK	VMID LN	11	0	0.10
International Equities		**46**	**0**	
US	VUSA LN	8	0	0.07
	XDPG LN	12	+1	0.09
Euro	VERX LN	6	0	0.12
Japan	VJPN LN	6	0	0.19
Asia	VAPX LN	5	-1	0.22
Emerging Markets	VFEM LN	9	0	0.25
Fixed Income		**12**	**0**	
Government Bonds				
UK	IGLS LN	2	-1	0.20
US	IBTS LN	2	-1	0.20
Index Linked Gilts	INXG LN	3	+1	0.25
EM	JPEA LN	2	0	0.40
Corporate Bonds				
US	CORP LN	3	+1	0.2
Alternatives		**9**	**0**	
Gold	PHAU LN	3	0	0.39
Infrastructure	INFR LN	3	0	0.65
Agribusiness	SPAG LN	1.0	-0.5	0.55
Water	IH20 LN	2.0	+0.5	0.65
Commercial Property		**3**	**-1**	
US	IUSP LN	1.0	+1	0.40
Europe	IPRP LN	1.0	-1	0.40
Asia	IFAS US	1.0	-1	0.59
Cash	GBP	**8**	**0**	
Total		**100**		**0.18%**

Courtville Partners	Model Portfolio	FTSE PI Balanced Index	Relative performance
2019	15.3%	14.0%	1.3%
Since inception(1/1/2015)	54.9%	46.2%	8.7%
CAGR since inception	9.1%	7.9%	1.2%

The value of your investments can fall as well as rise, and you may not get back all the money you invested.