

# CERNO CAPITAL

## Investment Letter dated 3<sup>rd</sup> November 2016

We draw close to the end of the Obama presidency. The very fact of it was remarkable even if the substance of it disappointed almost everybody. What comes next? The world, bar Vladimir Putin and those in America who will vote for Trump, would undoubtedly prefer Hillary Clinton to win the US election but it is hard to construct the case for much of a relief rally on the back of this. Trump gives the jeppers but Clinton commutes other risks, notably a perilous engagement with Syria and by proxy Russia. America is the land of second chances but it is also the place where the majority have had enough of the Clintons.

New leaders are apt to express frustration with touchy technocrats at their monetary authorities, as Mrs May has just done. Carney bristled in a manner that betrayed an insecurity. There are genuine risks and undesirable side effects of QE that properly form part of the national debate and are not beyond the purview of this or any other Prime Minister.

Politics certainly catches the eye. Last year David Cameron was Parliamentarian of the year at the Spectator awards. This year, he is in a garden somewhere in Oxfordshire watching the rhubarb grow.

And whilst the news concentrates on the various lurid personalities (Nigel, Donald, Boris and the others) the real story is us, the electorate. We have grown progressively dispirited and cynical about our minders and this has been coupled with a noticeable fall in real incomes affecting all but the top 1%. They have been served well by QE and the central bankers who have administered it. So the anger (our anger) extends beyond the political body into other institutions which are no longer believed to be neutral.

Capitalism is under pressure (how else could the Marxist tribute band led by Corbyn and McDonnell rise?) and the vent hole is to let labour (small 'l' here) do better.

We can see this already in America where corporate margins are beginning to fall as wages rise. We have reached technical full employment that of itself commends normalisation of interest rates. The resultant mix: moderately higher inflation, higher interest rates, lower margins and sluggish global growth will lead to disappointing corporate profits at a time at which equity valuations are high.

For these reasons, and not the politics, we do not like US equities and have taken protection.

For the UK, a global investor need not meddle with the messy mechanics of Brexit which need a few years to sort out. Our core case remains for a recession here so in allocation terms we are out of UK assets.

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The issue of Brexit is so intractable that is likely to consume many political careers and possibly also successive governments. The appearance of chaos is a real prospect. Assets would be interesting at that point.

Our residual interest in the UK lies in what the Treasury may do to stimulate infrastructure spending and what novel structures could be devised to commute private savings into them. We will be analysing these on behalf of our clients and if Phillip Hammond does not have something to say about this in his Autumn Statement then he has not used his first few months in his new office well.

We also believe Japan and the US will seek to boost infrastructure activity although the Japanese have been doing this for some years already. Large economies will seek to augment deficient growth, and salve to their disgruntled electorates in this manner and other, less-large economies will emulate them.

The easiest way to play this is to own a basket of global companies that build, facilitate or provide materials to such projects. We have built such a basket.

We are closing in on a period (which may have already begun) where financial assets do not deliver what is expected of them. Bonds have topped, equities are likely to struggle but, at the same time - on account of the coming inflations - cash all by itself is not the answer.

Our answer is to be global, both across assets and currencies and to run protection at this time.



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