SKERRITTS VIEW - OCTOBER 2018

Why the Midterms Don't Matter:

We've had a number of questions regarding the US midterm elections that are due next month and how these may affect the state of US politics and the consequences of any realignment of the respective Republican and Democrat parties. Firstly, let's be clear on one thing. As managers of UK clients' investments, it's not for us to be judgemental or take sides on who is right or wrong. Our job is to position our funds and portfolios as best we see fit to reflect the ***actual situation*** that exists (or may exist). Our expectation is that the elections will be terrible for President Trump. Does this mean that our expectations are that the US will begin to move in another direction regarding Trade Wars and Iran? Not at all. In fact, the position with both is most likely to harden, however the balance may shift in the Senate or Congress.

Why is this? Because the American people voted for Trumpism, not Trump. Even the Democrats have recognised that the majority of Americans actually sympathise with the idea that China have been getting away with things for too long and that someone had to take a stand. This goes too for the member states of the EU, and in Japan. Where there is massive difference, of course, is in the **methodology** being pursued. It's fair to say that, on the whole, the US electorate are no great fans of free trade or globalisation, and being the largest closed economy in the world, they are in quite a strong position to up the ante against their so-called adversaries.

So, in our opinion, even if President Trump was to be impeached later this year or into next, it would have very little effect on corporate US as a new President would pursue the same policies as now, but in a less "Twittery" way.

Why the Midterms Do Matter:

Saying that the midterms don't matter doesn't actually mean that they don't matter. They do matter. But they matter for the reason that we can probably expect a rise in the aggressive rhetoric, and actions, from a wounded President on a world stage that is one of the few unifying theatres that he can play in.

The sharp rise in the oil price has taken many by surprise. Being very aware that self-praise is no praise, we'd like to point out that we were not among the surprised ones. In June's publication we actually wrote that, *"the potential price of Brent Oil is being underestimated by the market, which sees only a 30% chance that it will be $80 a barrel by year end and a mere 14% that it will be $90. An inclusion of an oil ETC seems to be a sensible hedge to hold within a portfolio at the moment."* We duly added a Brent Oil ETC to all of our range (excluding income vehicles) and Brent has subsequently risen to around $85 a barrel at time of writing.

So where does the oil price go now? Well, in our view, it's got further to go. Most of the risks are to the upside.

Iran is not North Korea

North Korea only had two gears in its confrontation with President Trump – park, or apocalypse. Fortunately the latter didn't make sense.

Iran are a completely different opponent. Apart from being a major oil producer itself, it also controls the Straits of Hormuz, through which most of the oil from the Middle East flows.

Their big rival in the region is Saudi Arabia and sitting between the two bitter Sunni v Shia adversaries lies Iraq. Within Iraq there are growing tensions even between Shia v Shia, and should this erupt around Basra it will be doing so in a region that produces around 3 million barrels a day.

On top of this, there are indications that ISIS are regrouping in Libya, another oil producing country. The big tragedy of Syria is that it is not oil rich and so did not attract the attention of "outsiders" in the way these other regions will.

As far as "OPEC 2.0" is concerned, there is a suspicion that the supposed 2 million barrels a day that Russia and Saudi claim to hold in reserve are not actually there, while US shale has major transportation issues until the end of 2019 at least and will not help "oil" the global supply squeeze that is potentially coming. Add a dysfunctional Venezuela to the mix and it is hard to see how a pick-up in US – Iran tensions can be anything other than likely to see oil prices go higher still.

With the US also exerting pressure on the rest of the world to adhere to the sanctions that are due to be implemented in November, we're not removing our Brent positions any time soon. In fact, the oil price is likely to become one of our "themes" and we will be looking for other beneficiaries should our forecast be correct.

Let Others "Bottom-Fish" Emerging Markets:

There appears to have been a lot of "bottom-fishing" recently by other managers in the emerging market space. We're happy to let them continue to do so and feel that we are not going to miss out.

If we're right about the oil price, this has a couple of "hidden" effects on emerging markets. First, this will be the first time that the Emerging Market consumer will feel the price rises directly because between 2014-16 the IMF advised EM governments to cut the subsidies that had previously been in place.

Second, the Federal Reserve does not take any notice of the oil price when it's making its' rate decisions, seeing it as idiosyncratic. Consequently, if, as we and the rest of the investment community expect, interest rates continue to rise in the US well into 2019, the US Dollar is likely to remain strong. But the EM level of USD denominated debt is at its highest since the 1990s, so a stronger Dollar, in conjunction with a rising oil price, backed up by an ever-developing trade war between the US and China (with whom the bulk of EM region actually trades) is not a set of ingredients that excites us and makes us want to dash back in to pick up any bargains that are on offer.

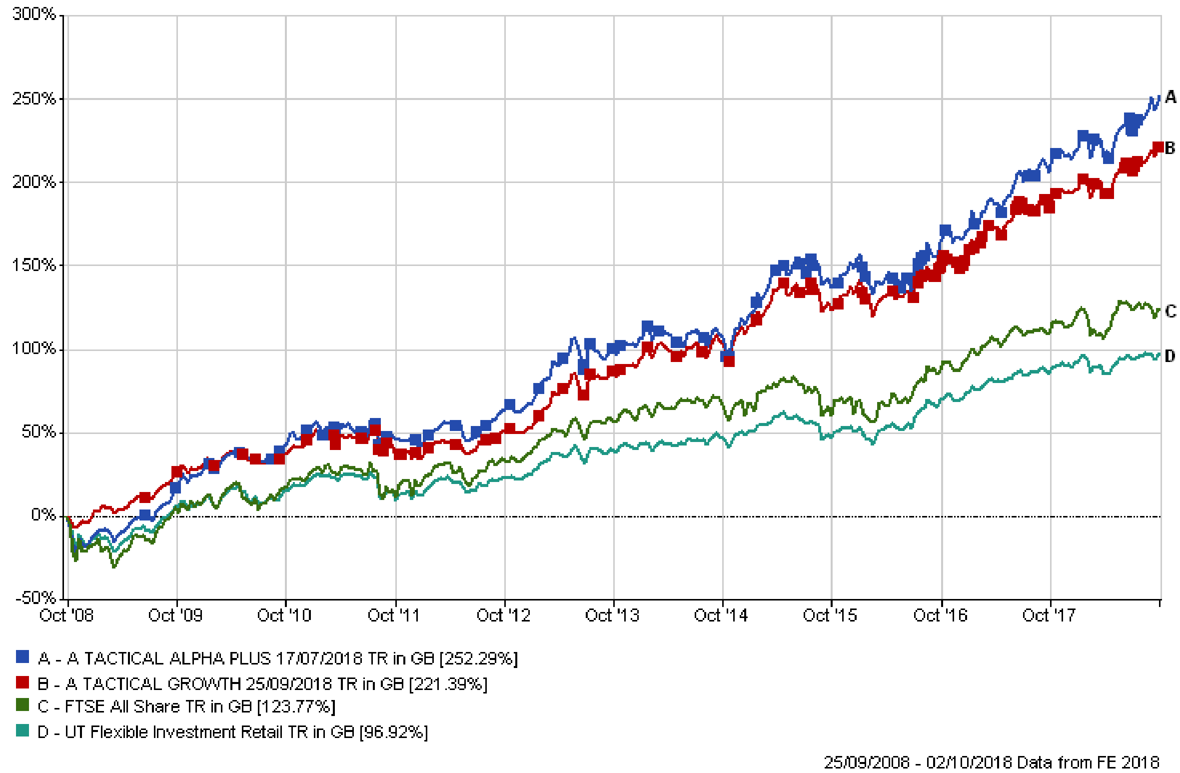
To our mind, simply buying something that has gone down, is silly. Yes, EM may rally in the short term, but with the various risks that we've just outlined it seems to us that by rushing to invest now is simply finding a way to lose your money all over again within the next 12 months.

But, without differences of opinion and differing timescales, a market could not be formed, so we always like it when there are two sides to a story. Your performance is the judge of whether you win the argument more often than you lose.

10 Year Anniversary:

Talking of performance, the Skerritt model portfolios celebrated their 10th anniversary last week. Launching into the midst of the Financial Crisis was, shall we say, character building, but looking at the chart below we don't think we've done too badly, particularly with our Tactical Alpha Plus and Tactical Growth Portfolios (gross of fees).

We'll be producing something that explains how we run the portfolios in more detail soon, and in particular how we have taken the next step of unitising versions of them into funds.



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