## Trying To Be Like Warren Buffett Is To Look Foolish – No, Really It Is:

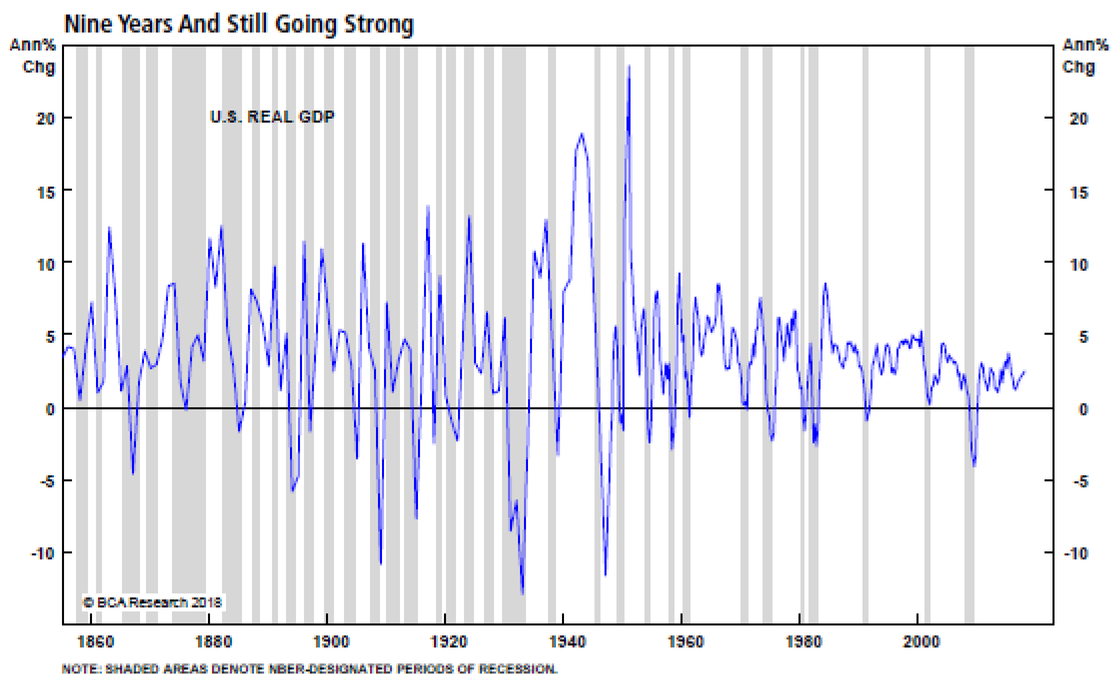
Great people have a knack of making you feel at ease. Probably the best known investor on the planet, Warren E Buffett, has recently issued his 2018 letter to investors in the Berkshire Hathaway fund that he heads in the US and in it he dispenses nuggets of sage advice for those who want to make better investment decisions. Our favourite this year is how he describes the qualities that one needs in order to seize opportunities when markets behave irrationally (the ☑s are our own): it "does not require great intelligence ☑, a degree in economics ☑, or a familiarity with Wall Street jargon such as alpha and beta ☑. What investors then need instead is an ability to both disregard mob fears or enthusiasms☑ and to focus on a few fundamentals. A willingness to look unimaginative for a sustained period – or even to look foolish ☑☑☑ - is also essential."

Within one calendar month, the S&P500 index in America lost 7% in value before making it back up again. If you had hibernated in a box throughout February, you would have had no idea of the noise, chatter, discussion, debate and pontificating that enveloped the financial news channels and press during these relatively few days, all apparently to no avail. It is the ability to disregard the noise made by the mob that allows sensible strategies to be formed and followed.

## Preparing To Look Foolish:

It is with some confidence that we are prepared to look foolish in the coming weeks. Let's examine some fundamentals.

Markets don't drop by 7% for no reason. Tempting as it is to ignore it, it may be wrong to do so. It is a fundamental truth that the current economic expansion will be the longest in history if it can keep going until July 2019. The fact is, it has to end some time.



There is an old saying that "Expansions do not die of old age. They are murdered by the Fed." Was it coincidence that the correction in February coincided with data being released that suggested that inflation may be making a return? Higher inflation leads to higher interest rates, and the new Chairman of the Fed, Jerome Powell, used his inaugural address to indicate that he would most likely gradually raise rates over the coming months. Three rate rises are all but certain this year. Most likely it will be four, and it is also likely that a further three or four could follow in 2019.

It is also a fundamental truth that the rise in populism seen in recent elections in the US, the UK and across Europe is giving rise to more fiscal profligacy by the respective Governments. The US have announced major tax cuts and even more major spending plans on infrastructure and other public expenditure. The normally fiscally conservative CDU Party in Germany has formed a coalition with the looser SDPs and agreed an additional 46 billion Euros to be allocated to public investment and tax cuts. Any rate rises that we've alluded to may be too little too late in an overheating economy.

## Fundamental Truth Number 3:

Fundamental truth number 3 is that bond yields are rising. We set ourselves a target at the turn of the year to mark up as a danger sign to equities when the 10 year Treasury yield in the States hit 3%. The S&P 500 fell 7% just after the yield reached 2.88%. Having retreated a bit, it's now back to just over 2.9%. It is now probable that it could rise to 3.25% or higher as the year progresses. Why is this relevant? Because yields over 3% begin to look more attractive for investors who want a low risk rate of return and the dividend yields on offer from stocks don't compensate a low risk investor sufficiently for the short term risk that stocks ***always*** carry. If institutional investors begin to exit the equity markets in high numbers, there's only one way that the S&P is headed.

## Fundamental Truth Number 4:

We like fundamental truth number 4. This is the truth that says that regardless of the forecasts of higher rates and higher inflation, the global economy is still in good shape and the Leading Economic Indicators that align from time to time to forecast gloom and wealth destruction are nowhere near a level to worry about the bottom falling out of the market any time soon. As we've seen in February, there are some very good reasons to remain invested in markets for now, as the recovery in such a short period was decisive.

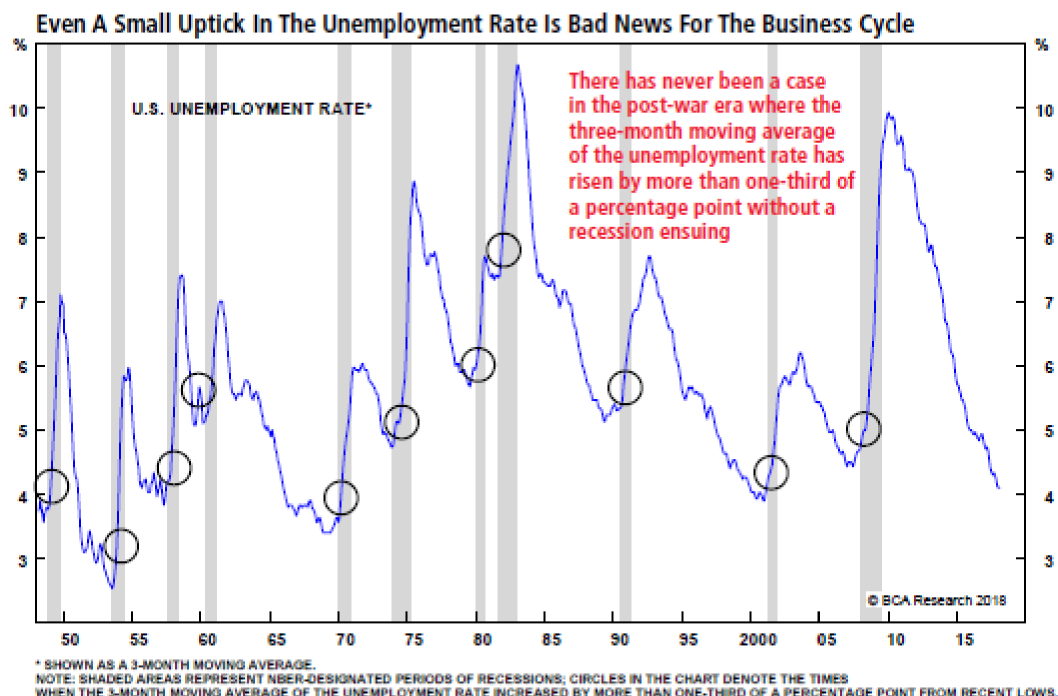
## Fundamental Truth Number 5:

The world changed in 2008 with the Financial Crisis and is still coming to terms with what those changes mean. QE and a low interest rate/low inflationary era has created a new backdrop to what is normal. The explosion in freelancers, self employed, renewable contracts, zero hour contracts, part timers, flexi-timers, globalisation and freedom of movement has changed the nature of wages for the foreseeable future. Wages don't go up much, so no one ***feels*** better off. We talk about interest rates rising, but it's impossible for them to rise to anywhere near previous levels without triggering a massive backlash from an electorate cast into a deep and savage recession. Investors need to adjust

their base thinking to align with the times. Or, in other words, what worked before won't necessarily work today, which is why so many investment "names" are disappearing, or have disappeared.

## Fundamental Truth Number 6:

The next recession will arrive, and when it does it is likely to be particularly nasty and painful on many levels. It won't be avoided, but it can be successfully navigated. When will it arrive? That, sadly, is unknown. It's a bit like a seismologist who knows that San Francisco will suffer another earthquake or a cardiologist who tells you that if you carry on a certain lifestyle you will most likely suffer a heart attack – the basics are known but the actual timing is not.
One thing that we will be keeping under surveillance is the employment figures in the US. The following chart is, well, graphic, in its portrayal of the link between rising unemployment and a forthcoming recession. The figures from the other side of the Atlantic are not showing any signs of deterioration at the moment, but if one considers the news in the UK recently surrounding Toys R Us, Maplin, restaurant chains such as Jamie's Italian and Prezzo, and the rumours swirling around the City of major banks and financial institutions relocating to Europe, the signs are not so good for the UK in the coming months.




## Investment Conclusions:

For the time being, with a recession seemingly not on the horizon and growth continuing to chug along nicely in the US, Japan, Europe and Asia, we are happy to maintain a "foot on the pedal" approach to our funds and portfolios, but largely in a sector sense rather than geographic. It is a fundamental truth that cyber security, robotics and automation, battery development, healthcare and biotechnology, and an ageing population are themes that are not going away soon, so we will continue

to invest in them. The haves and have not divide is getting wider, and so we will maintain our interest in luxury goods and premium brands. The ongoing uncertainty around Brexit means that we will have little or no exposure to the UK market, even though most of us live and work here. We prefer investment logic to guesswork.

**These are our views and are for professional use only**

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