Skerritts View June - 2018

Trying Hard To Keep Up:

World events keep moving at an unpredictable and unprecedented pace, making it exceptionally difficult to keep up with all the shenanigans. Let's take the last couple of weeks, for example *deep breath*…..

The world is shocked to hear that the main combatants in the US-North Korea spat are going to meet up and chat things through over a cup of tea in Singapore while at the same time sanctions are announced against Iran by the US in a reversal of the negotiated plan between the previous US administration and Tehran. China and the US appear to have stepped back from a harmful trade war and the Italians prepare to go to the polls with the least likely outcome seeming to be a coalition between the Roman equivalent of parties led by Corbyn (5S) and Farage (Lega).

Just before the weekend arrives the trade war is back on between China and the US as America announces that the original tariffs are going ahead after all. This coincides with the surprise announcement that the tea party in Singapore is now off as one mild insult too many has been made from one participant to the other. The Italian election delivers no definite result, with the coalition between the Roman equivalents of Corbyn and Farage still seeming to be the least likely outcome.

Not far into the week, a coalition is announced in Italy between the Roman equivalents of Corbyn and Farage. The equity markets, bond markets and the Italian President, freak out. Neither of the parties concerned quite believes what has happened as neither leader wants to be Prime Minister in case they get blamed for the inevitable mayhem to follow. They appoint a university professor with no political experience instead.

The North Koreans *really* want to chat things over in Singapore and make conciliatory noises towards Washington. Washington responds by confirming that the talks remain off. A couple of days later the US welcomes Kim Yong-chol, the former military intelligence chief and one of the North Korean leader's closest aides for dinner. Tea in Singapore is back on. At least Russia are not getting involved with the North Korean situation.

Breaking News: Russia announces that President Putin is to meet with Kim Jong-un in Moscow.

The Italian President is so freaked out by the new 5S/Lega coalition that he says he's "not 'aving it" and refuses to acknowledge the proposed Finance Minister. 5S and Lega are "not 'aving it" even more and pull out of government. Italy now has no government, the President has poured petrol on the populist flames, each radical side garners more support than before and a new election looks inevitable which could question the very substance of the European Union. The university professor resigns from a position he never really had and the equity markets and bond markets freak out even more. The Italian President keeps his head down.

As the weekend approaches, 5S and Lega come back to the Italian President with a Finance Minister that he will recognise and they resume the formation of a government made even stronger by the attempts of the Italian President to weaken them. Having freaked out when the coalition was first announced because of the threat they posed to longer term national solvency, the equity markets and bond markets rejoice that there is a government of any kind back in place, putting to one side the reasons they freaked out in the first place.

At least relations between Trump and his allies in Europe and Canada seem firm after various visits and signals of support.

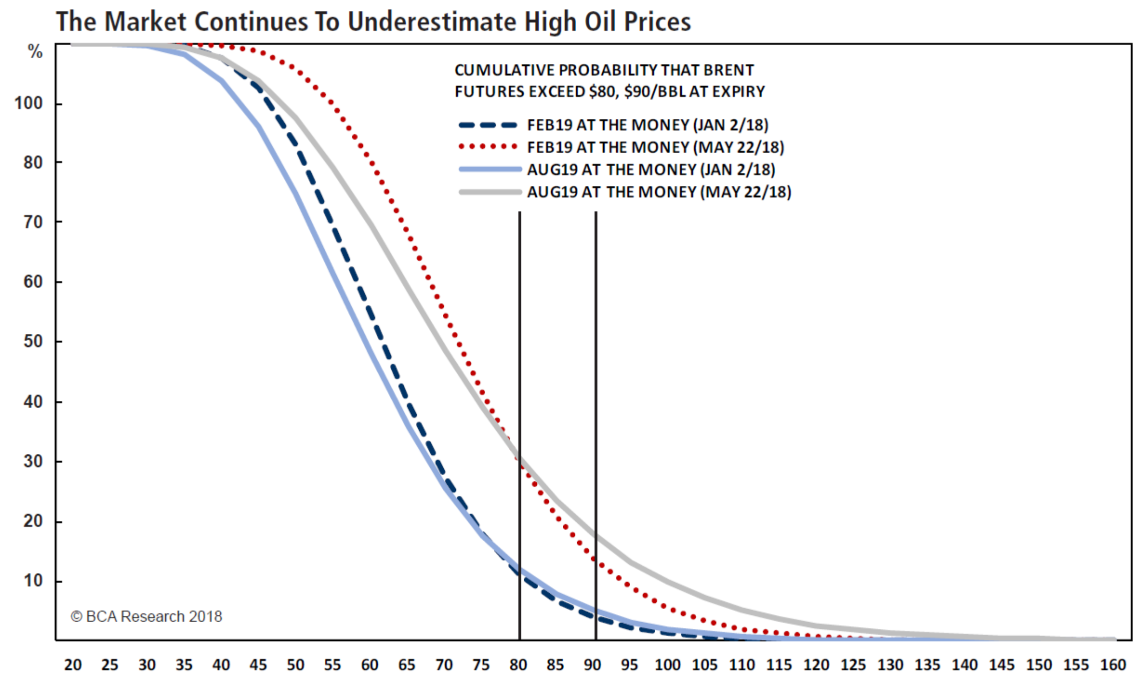
The US announces tariffs against its allies' steel and aluminium. The sources of the recent signals of support are quoted as saying that this move is "illegal" and "absurd". Oh, and Spain oust their government……

…….*and breathe*

Making Sense Of It All:

How do you make sense of it all? About the only chance you've got, as investors, is to keep things simple. One trick that we're getting used to is the Chris Tarrant style of diplomacy from *Who Wants To Be A Millionaire*, "but we don't want to give you that…". So when an announcement is made by the White House, there's very often a conflicting and contradictory one that follows soon after, so don't react too quickly to a tweet.

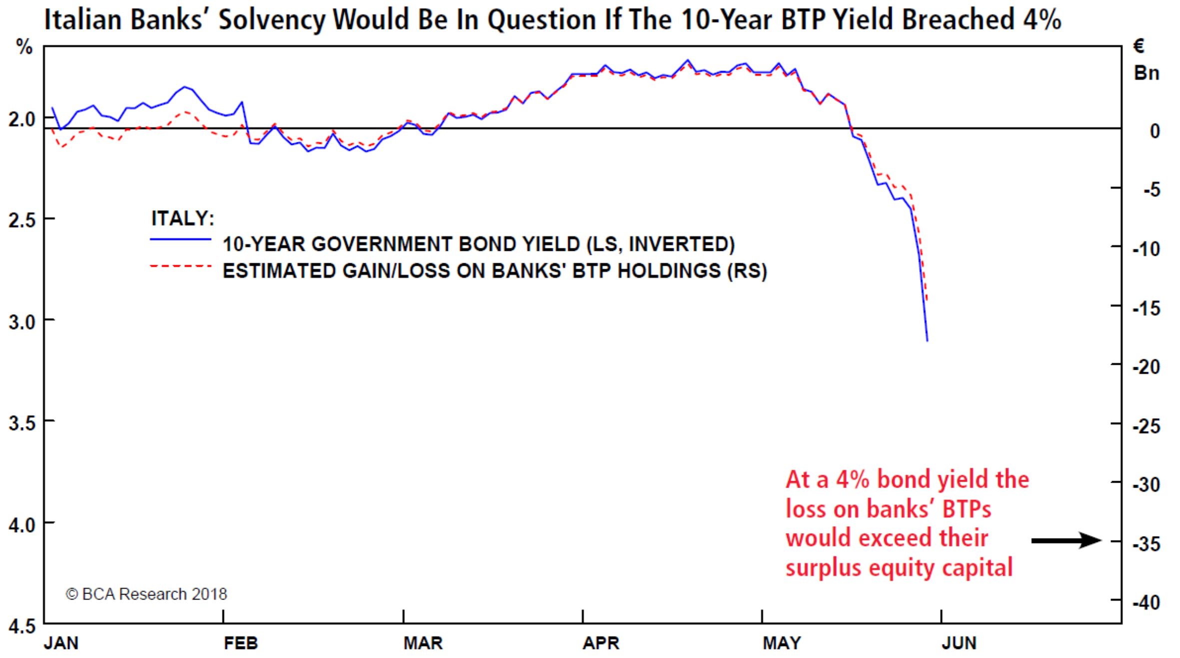
Another thing that we're learning is that when things have gone quiet for a while, they tend to come back centre stage with a bang. Consequently, we have not mentioned Iran since the very beginning of our summary to date. Buoyed by his apparent tactical success with North Korea, we're expecting the US-Iran issue to raise its head again fairly soon, particularly as Russia are involved with the Saudis in dictating OPEC policy (who would have thought that the World Cup would kick off with an OPEC Derby duel between Russia and Saudi Arabia?). Iran have many more strings to their bow than North Korea when it comes to retaliatory action and we agree with BCA Research when they say 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 [see below].



An inclusion of an oil ETC seems to be a sensible hedge to hold within a portfolio at the moment.

A 4% Target For Italy:

Trying to follow the Italian soap opera is equally difficult so we'll keep it simple by setting a target of 4% on Italian bond yields before we get too jumpy ourselves. Why? The risk that the new government (today's, that is) poses to markets is in their spending plans. This will push Italian bond yields higher, weakening Italian banks which have been the last to repair themselves since the Financial Crisis. This threatens the Italian economy, which strengthens support for parties and policies that push back on the EU, which raises bond yields further which….you get the picture. A vicious circle develops. Using the equity capital that Italian banks hold against the net non-performing loans they have on their books, BCA estimate that a 4% bond yield is "the line in the sand" at which risks escalate significantly. Who knows who owns or holds what between the various European (and global) banks' balance sheets. We're not at Greek Crisis Part II yet, or particularly close to it to be frank, but it's something to be very aware of.



Which Leads To Our Simple Conclusion:

If, as we've proposed in previous months, markets don't peak until 6 months before the onset of the next recession, and we're more than 6 months away from the next global recession, markets have not peaked yet. As we've illustrated, there are plenty of things to worry about, but are they ***cycle-ending?*** We think not. This isn't to say that volatility won't be with us throughout the summer, but remember 1998 when a long bull run was in the maturity phase and markets fell 22%. The subsequent recovery was around 68% until the big one hit in 2000. If we can continue to capture the themes that are not going away from the investment landscape any time soon (cyber security, robotics, innovation etc) then we will ride through any volatility in the meantime. The current speed of global events simply makes it impossible to keep up, and time effectively, any major changes. Keep it simple and you're halfway towards keeping your head through the apparent madness around you.