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ASSET MANAGEMENT (C.I.) LIMITED

INVESTMENT MEMORANDUM

It has been a good quarter for international equity investments with only isolated pockets of negative performance. They have outperformed fixed interest securities. In the currency markets, sterling was notably weak boosting the sterling performance of overseas assets. Gold remained a disappointing performer.

The tables below detail relevant movements in markets :

International Equities 30.04.18 - 31.07.18

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	+6.5	+10.1	+4.8	+8.3
Finland	+1.6	+3.3	-1.6	+1.6
France	+2.6	+4.3	-0.7	+2.6
Germany	+1.8	+3.5	-1.4	+1.8
Hong Kong, China	-3.1	+1.8	-3.1	+0.1
Italy	-5.6	-4.0	-8.6	-5.6
Japan	-0.9	+1.7	-3.1	N/C
Netherlands	+4.3	+6.0	+1.0	+4.3
Spain	-0.3	+1.4	-3.5	-0.3
Switzerland	+4.1	+9.3	+4.0	+7.4
UK	+4.1	+4.1	-0.9	+2.4
USA	+6.8	+12.1	+6.8	+10.3
All World Europe ex UK	+2.2	+4.6	-0.4	+2.9
All World Asia Pacific ex Japan	-1.6	+1.4	-3.4	-0.2
All World Asia Pacific	-1.3	+1.6	-3.3	-0.1
All World Latin America	-4.7	-4.3	-8.9	-5.9
All World All Emerging Markets	-1.8	+0.7	-4.2	-1.0
All World	+3.9	+7.7	+2.6	+5.9

Source : FTSE All World Indices

FTSE UK Government Securities Index All Stocks (total return) : +0.8%

International Bonds - Benchmark Ten Year Government Bond Yields (%)

Currency	30.04.18	31.07.18
Sterling	1.48	1.39
US Dollar	2.96	2.97
Yen	0.04	0.06
Germany (Euro)	0.50	0.33

Sterling's performance during the quarter ending 31.07.18 (%)

Currency	Quarter Ending 31.07.18
US Dollar	-4.6
Canadian Dollar	-3.3
Yen	-2.3
Euro	-1.4
Swiss Franc	-4.6
Australian Dollar	-3.2

Other currency movements during the quarter ending 31.07.18 (%)

Currency	Quarter Ending 31.07.18
US Dollar / Canadian Dollar	+1.4
US Dollar / Yen	+2.5
US Dollar / Euro	+2.3
Swiss Franc / Euro	+2.3
Euro / Yen	-0.9

Significant Commodities (US dollar terms) 30.04.18 - 31.07.18 (%)

Currency	Quarter Ending 31.07.18
Oil	N/C
Gold	-7.4

MARKETS

International equity markets have performed well over the quarter. The total return on the FTSE All World Index in local currency terms was 3.9%, in sterling terms it was 7.7%, in US dollar terms 2.6% and, in euro terms, it was 5.9%. The outstanding markets in local currency terms were the USA and Australia. The FTSE USA index returned 6.8% and the FTSE Australia index returned 6.5%. On the negative side, the underperformers were the FTSE All World Latin America Index which returned -4.7%, the FTSE All World All Emerging Markets Index which returned -1.8%, the FTSE All World Asia Pacific ex Japan Index which returned -1.6% and the FTSE Japan Index which returned -0.9%. With sterling being weak, sterling returns were enhanced such that the FTSE USA Index returned 12.1% and the FTSE Australia Index returned 10.1%. Negative local currency returns from the FTSE All World Emerging Markets Index, the FTSE All World Asia Pacific ex Japan Index and the FTSE Japan Index all became positive in sterling terms with only the FTSE All World Latin America Index remaining in negative territory at -4.3%. The UK, having slightly outperformed in local currency terms, underperformed the FTSE All World Index in sterling terms.

International government bonds, as measured by ten year government bond yields, produced a slightly mixed performance. The gross redemption yield on the UK government bond fell by 9 basis points to 1.39% and on the German Bund by 17 basis points to 0.33%. On the other hand, there was a 1 basis point rise in the gross redemption yield on the US Treasury bond to 2.97% and a rise of 2 basis points on the Japanese Government Bond to 0.06%.

As indicated above, sterling endured a weak quarter. Against the US dollar and Swiss Franc it fell by 4.6%, against the Canadian dollar by 3.3%, against the Australian dollar by 3.2%, against the yen by 2.3% and against the euro by 1.4%.

Oil, as measured by Brent crude, was unchanged over the quarter whilst gold put in a disappointing performance, falling by 7.4%

ECONOMICS

This month’s memorandum has been written backwards or, more accurately, this first paragraph has been added after the completion of the body of the text. The point of noting this is to highlight the fact that the word Trump figures 27 more times over the following pages and this will inform the reader of this month’s area of focus. It is exceedingly difficult to avoid writing about him at present.

As in previous iterations, this month’s commentary has a global focus and yet, unusually, speaks almost entirely about the United States. Such has been the election of Donald Trump, to lead a country of unambiguous might through its global influence. Many clients of Meridian will be aware of the need to complete documentation to satisfy the American tax authorities (W-8BEN and W-8BEN-E forms). The United States regularly holds banks and companies to account, where they are based elsewhere, for doing business in places it doesn’t want business to be done, an example of that is in Iran at present. (The United States is not alone in this reverse internationalism with the E.U. catching up fast). A third area of more significance, which is very current, is the nascent trade war between the largest trading blocs of the world, started by the American President. At present, markets remain of the view that there will not be a major escalation and that wise counsel will prevail in high office. At the same time volatility is raised because the possibility of an intensification is very real.

Any casual observer would find it easy to describe accurately Donald Trump's general demeanour. His stance on world trade probably mirrors that of most areas of policy administration and may well be the distillate of forty years of deal-making. It's either an over-confident bluff or a confident of all-out victory opening salvo. That confidence, here and elsewhere, is born of his clear view on America's status - Number One in the world. There are three major economic powers at the centre of this - US, EU and China. Japan, US's neighbours and UK follow after.

Why does Trump think he's guaranteed victory in this war? His image of world trade is that in any trade the buyer is more important than the seller. May the seller beware! Trade is bilateral and world trade is the sum of countless bilateral deals. America is the victim of world trade because its ongoing purchase of overseas output is greater than its export of home-produced goods and services. For Trump, too much of the buying is being done outside of the US and not enough selling inside it. He now amply demonstrates that he sees in his gift the ability to move the goalposts (to use a timely metaphor) by adding costs to the away team (to stretch the same metaphor). What seems less clear is his anticipation of the opposition's next moves in each case. The theory relating to tariffs works best in the simplest example. If a country were unilaterally to introduce tariffs on, for example, steel and it were met with no counter-measures, then a meaningful rebalance of trade would occur, assuming that all steel products were interchangeable i.e. a car factory in U.S. could effortlessly substitute domestically produced steel for imported steel. This is where the reality differs from theory. Firstly, there must be a good reason why the car factory is buying foreign steel products in the first place. Either the quality is superior, the cost is lower or there is some combination of the two. Contractual obligations will be a factor as will, with some likelihood, wider and deeper relations between erstwhile foreign supplier and importer. Then there are the consequential effects. The car factory is likely to be introducing an inefficiency in having to either pay up for the now more expensive imported steel or use inferior second choice American steel. This could have an effect on the price of the finished car which will mean American consumers will either choose to buy fewer of them or have less money to spend elsewhere in the American economy. Those cars that are earmarked for export will be less competitive. This simplified overview just considers the possible consequences of the imposition of one unilateral tariff. It is disruptive to the factory, the shipper and the supplier and will introduce inefficiencies. In last month's memorandum the example of Harley-Davidson was highlighted where tit-for-tat tariffs on American produced products by E.U. and elsewhere were leading the company to consider shifting production away from American to alternative factories in Thailand, India or elsewhere. It is clear that the reality of tariffs quickly moves away from the original intention, here European tariffs threaten to add $2,200 to the cost of each motorbike and this in a fiercely competitive market where the iconic American bike company was already struggling to maintain market share.

A good example of how it is difficult to predict real outcomes has been seen in July relating to the tariffs imposed by the United States on China. The 'base case' is that matching reciprocal tariffs are placed by the second country on the original instigator, so China would be expected to match America's tariffs. This, it would seem to Donald Trump, is where the United States will triumph because it has more physical Chinese imports to target than China has American. China did initially go down the matching route but now it appears that the leadership of the country is looking at alternatives, such as making trading terms more favourable for other trading partners such as E.U. and Japan. As they are competitors of the United States for access to the Chinese market then this may prove to be a potent tool in wilfully damaging America's economic interests. Another example cited in the Financial Times is that China offered $15 million in aid to the Palestinians at a summit as a carrot to Arab investors. What is clear is that no protagonist in such a trade war is going to emerge unscathed. History shows that higher prices and, hence, inflation tend to follow, with less choice for consumers who, at some point, will also be voters. This last point is much more of an issue in U.S. than in China giving the latter an advantage in the short game. Beyond that, everyone is interested in playing the long game with China - invest now and reap the benefits over time.

The reaction of markets, until this point, has been to price in the disruption to trade as limited in scope and timescale as, at this stage, the whole apparatus of international trade is not about to be dismantled. In terms of valuations, the fundamentals of companies' prospects of profit growth seem more important to investors than the political risk but President Trump, the great free market man, will also need to reflect on corporate America's ongoing reaction. To corporate America, which is not without influence in Washington, the tailwind of the tax breaks at the start of this year risks turning into trade headwinds. Manufacturers devote significant energy to lobbying because the political climate in which they operate has the capacity to influence greatly their smooth running. There is never a time of perfect conditions in which to do business but, taking the example of General Motors, there is now a heightened need to review their supply chain with regard to steel and aluminium price changes, to review retaliatory tariffs between key markets such as Mexico, Canada, the EU and the Far East, as well as its domestic one and a changing picture regarding NAFTA 2.0 (the most recent iteration of the North American Free Trade Agreement). There is currently a Department of Commerce investigation to "determine whether imports of automobiles, including SUVs, vans and light trucks, and automotive parts into the United States threaten to impair the national security as defined in Section 232". This reflects the special powers invoked by the President to introduce these trade measures as a matter of national security. The first change that a company will make in times of uncertainty is to cut investment which, in voter parlance, is fewer jobs. 25th July was the day that both General Motors, one of the three largest vehicle manufacturers in U.S., provided trading updates with GM noting in its press release that "recent and significant increases in commodity costs… have negatively affected business expectations" and went on to revise its full year outlook. The share price fell around 7% on the day. Ford and Fiat Chrysler made similar comments.

Under the checks and balances within the government of America the President is afforded certain powers, notably nominating Supreme Court judges, preparing the federal budget and being head of the military. His powers are far from absolute and Trump currently relies largely on national security powers to introduce tariffs though, as referenced in the previous paragraph, it may be a stretch to argue all of the tariffs introduced can be justified on those grounds.

A visit to the U.S Chamber of Commerce's website quickly takes you to a front page article titled "Trade works. Tariffs don't" where it opines "Tariffs imposed by the United States are nothing more than a tax increase on American consumers and businesses - including manufacturers, farmers and technologies companies - who will all pay more for commonly used products and materials". It then offers a click-through State by State map to show the financial impact of specific tariffs on sectors represented in that State. The U.S. Chamber of Commerce usually supports the Republicans and is the largest lobbying group in the country spending more money than any other group on a yearly basis (around $60 million in 2017). It is a short hop from lobbyist to politician and pressure, too, is growing on Capitol Hill, where politicians have, possibly, one eye on the mid-term elections in November, made all the more important because of the small majority held by the Republicans in the Senate. Markets, at this stage, can feel comforted that unquestioning support for Trump in this field cannot be found in large parts of Congress or commerce. Consumers may be next to demur though much damage may have been done by that point.

It could be inferred that the largest part of politics is simply the sum of economics plus elections. Donald Trump understands the economics and his highly personalised approach to the office he holds would seem to be borne from a tactically won election that most commentators said he could never win. It remains to be seen whether his 'I'll take 'em all on' approach can carry him all the way to his end goal or if its potential unpopularity leads him to move on to his next project.

America's new leadership has, in a narrow but powerful way, moved its position relative to the previous administrations. Through previous leaders and through its acceptance of climate change policy, terms of trade, share of defence spending, America's largesse was often on show in doing the right thing. It felt that it should be a moral leader and sometimes pay a price for it. Trump brings with him a desire to step aside from international engagement run via diplomatic channels, where the long term values and enshrined history with its allies are less important than driving a good deal, to directly benefit those that live in his country. If those other countries are incapable of protecting their commercial interests, Mr Trump does not see that as his mandate. His demeanour and rhetoric are clearly quite new on the international stage and he could not make it more abundantly clear that he has no regard for how he is perceived. Speaking purely as investors, our concern is far less about international relations but much more about international trade. Pre-election the majority of analysts would have strongly favoured Hillary Clinton as she represented an establishment vote and would, presumably, treat anything that threatened market disruption with a great degree of caution. Despite Trump's rumbustious presence, markets have not taken fright and, in fact, have been encouraged by the significant changes to the tax system and a fresh approach to spiralling regulation, despite a gentle reversal of monetary policy and higher oil prices. February was the most volatile month for equity markets and was caused by some slightly weaker economic data on earnings growth which suggests that market levels are being sustained in the belief that the medium term trend for economic growth is largely on track, for which Trump deserves not insignificant credit. This is where his position on trade is important as it straddles international affairs and economic wellbeing. It would seem that Trump's stance on this matter is uncomplicated. Through adjustment of the international trade system Trump thinks he can increase employment across his homeland and re-invigorate areas of economic privation. He believes that this adjustment is necessary because of policy mistakes of the past. He sees trade as a zero sum game where others doing well must be doing so at the expense of America and a simple forced pricing change will allow the pendulum to swing back in Trump's favour. None of these observations are new but we are, perhaps, moving into a new phase of Trumpian times, where less heed is paid to his doublespeak outside of America but politicians are increasingly nervous about the second stage impact. The Federal Reserve faces an unenviable task of keeping growth and price stability on target despite the uncertainties thrown up by erratic Presidential decrees/tweets/policy statements/resignations/other. The Chairman of the Federal Reserve, Jerome Powell, spoke on trade during the month, commenting "it is very difficult to predict how [trade policy] turns out and we'll just have to see" adding "when we don't make policy, we don't praise it; we don't criticise it". He also noted that the administration's professed goal is freer trade and lower tariffs.

It is worth underlining the comments above with some estimates from the IMF. Maurice Obstfeld, its chief economist, warned in July that the imposition of tariffs could potentially knock 0.5 percentage points off world growth in two years' time, adding that, if we got to that point, then stock markets would take a hit. This is a useful reference and is contingent on a situation where "current trade tensions escalate further" and would mean a progressive deterioration of trade volumes, a reduction in earnings and a loss of investor confidence. Without the adverse impact, world GDP growth, it estimates, will be at 3.8% in 2020 capping the period of solid, if unexceptional, growth that we find ourselves in at present. As such, this represents the largest current economic threat. Trump can justify his stance as in many cases tariffs between America and other key trading partners are not symmetrical and the Chinese ration access to their internal market - a key growth area for any global business and they do not respect intellectual property rights. An American electronic product can quickly be copied and sold internally under a domestic brand. In western countries robust and tested legislation protects against this.

Trump is a political phenomenon but this memorandum does not seek to explore the world of politics but to understand whether he is an economic phenomenon. The tax breaks he has introduced are estimated to have added 7 percentage points to corporate profitability where, it is expected, there will be a trickle down effect on economic growth to Americans through dividends and share growth, creating a wealth effect, but more broadly through investment, higher wages and lower prices for goods and services. Isn't this what politicians should do? This rhetorical question is not a comment on tax policy per se, but, rather, he shows a commitment to deliver on his pact with swing state America; this is shown more amply by his single minded "Make America Great Again", echoing an almost identical slogan used by Ronald Reagan. Delving back further into political history, Charles de Gaulle was quoted as saying to Clementine Churchill when she said "General, you must not hate your friends more than you hate your enemies", "States do not have friends, they have only interests".

President Trump is quite fair in that he treats all trading partners equally and his starting point is, almost without exception, that all are offside, in trade terms. His belligerent man-of-the-people Realpolitik in international commerce only works because the country he leads is the United States of America and he is prepared to be judged by the changes he makes to the lives of the workers of Michigan, Wisconsin and Pennsylvania, "blue wall" states that hadn't voted for the Grand Old Party since the 1980s. His regard for the views of any international elite do not concern him. In terms of this economic review, we continue to view his combative posturing on trade as being disruptive, without committing, at this stage, to it being inevitably bad. The US is victim of uneven trade terms and Trump borders on the bemused, that the country should ever find itself in that position.

Again, thinking about the economics, the trade war is no longer just a war of words, as reflected by Ford, GM and FiatChrysler's lower projections and with Harley-Davidson's operating margin falling below 10% from around 17% five years ago. In Europe, German car manufacturers' share prices have been hit and China has seemingly derailed chipmaker Qualcomm's $41 billion bid for Dutch competitor NXP Semiconductors simply by its regulator failing to reply to a request for dialogue with the American manufacturer. These would appear to be the wounded in early skirmishes but there are no outright casualties and markets rose sharply on 25th July when it emerged that Trump's meeting with Jean-Claude Juncker led to a pledge from both to eliminate tariffs, trade barriers and subsidies for non-automotive industrial goods, with Trump agreeing not to impose car tariffs. Talks also covered cars, soybeans and liquefied natural gas. It may well prove that a tentative agreement with Juncker hints that Trump may be economically cannier than some give him credit for and his business mind works more effectively than his bluster suggests.

A unifying trait of all economists is that there are always things to worry about. The complexities and subtleties of the world economy invite a myriad of views on policy, action and reaction and long term consequence. At present, Donald Trump invites criticism for the direct threat he poses to world trade - and there is almost unanimity that global free trade is an efficient conduit for prosperity, but also praise for the economic stimulus he has foisted upon his domestic economy through the tax changes. Universal approval for this is absent because of the risk that it could prove pro-cyclical given it adds stimulus to an economy that is already performing strongly. Second quarter growth figures were estimated at 4.2% and first quarter growth revised up to 2.2% from 2.0% with consumer spending growing by 4% and non-residential business investment by an impressive 7.3%. Monetary policy is being tightened but there is, of course, great sensitivity to interest rate rises and changes in the speed of interest rate rises. Debt affordability, at this point in time, is an important consideration and pressures may be building faster if inflation starts to climb through greater consumer spending or, in economic terms, excess demand.

Economic pre-eminence shifts over time. At the risk of sounding imperialistic, the world economy in the 19th century was dominated by Great Britain and her dominions, the last century belonged to U.S. but the economic picture continues to develop. In 1960 U.S. GDP represented 40% of global GDP in dollar terms. It is now somewhere around 24%. It has consistently grown wealthier but other countries have grown wealthier and more populated at a faster rate. It is easy to see that the centre of economic gravity is moving relentlessly in an easterly direction and it is hard to argue that the next century won't be dominated by Asia. Investing is less about counting populations and charting national GDP trends and more about an informed understanding of which companies are best placed to benefit from growth, wherever it may be. Whilst United States contributes less than a quarter of world output, its companies are disproportionately well represented and it is common for Meridian portfolios to have a much higher geographic exposure in percentage terms. We continue to maintain faith in the direction of United States and continue to believe that in terms of culture, ambition, management style, financial strength and political clout there are a great number of world class companies based there. Our base case remains that a fully blown trade war, which triggers a collapse in markets, is unlikely and we continue to remain largely fully invested. Where cash has built up in portfolios we will look to reinvest on short term setbacks. Bonds, intrinsically, will underperform in times of rising interest rates and, with no change in current expectations, can only perform a very limited part of our clients' portfolios and this is limited to short dated bonds whose performance is close to cash. The importance of the USA and other overseas markets is emphasised by the political turmoil in the UK which, to us, remains a high risk market, not so much because of Brexit, but more because of the uncertain political situation. A widely diversified portfolio by geography is always wise but especially so in current circumstances.