Cazenove Capital

October 2017

Market update

Economic growth upgrades but weak wage growth and low productivity

We are in the eighth consecutive year of growth since the end of the 'great' recession. When the process of recovery began, we were right to expect duller, safer growth than had been recorded during the 15 years prior to the recession. What we did not foresee, was that job creation would be as strong as it has been, or that productivity growth would be so weak.

The weakness in productivity has had meaningful consequences and has been reflected in subdued real wage growth. As a result, there has been a growing feeling in advanced economies that working people are not sharing in the benefits of growth. This has had an economic impact, but also a social impact, illustrated in anti-establishment election results on both sides of the Atlantic.

European growth improvements offset UK loss of momentum

The current economic cycle of slower, lower growth is characterised by a distinct lack of cyclicality in most advanced economies. That is not to say that all economies are showing the same pace of growth. In the UK, slower real income growth and Brexit uncertainty have caused a modest slowdown in growth. The US has gained momentum during 2017, although not to the extent some anticipated at the start of the year. Meanwhile, the Eurozone, having lagged the rest of the developed world, has seen a notable improvement during 2017 and looks set to record the best annual gain in GDP since 2010 – but still only just over 2%.

Structural factors keep global inflation subdued, but interest rate normalisation expected

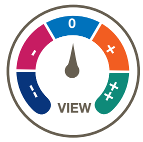
Longer-term structural trends such as the disruption from technology, demographics and globalisation have resulted in subdued inflationary pressure across the world. There are still cyclical influences that can see inflation pick-up in specific regions. For example, sterling weakness and a recovery in commodity prices have put upward pressure on prices in the UK.

Low global wage inflation has taken pressure off policymakers. However the tone of global policy debate seems to have changed, particularly in the US where a gentle process of normalising interest rates is under way. In the UK, it is expected that rates will start rising by the end of this year and in the Eurozone the ECB is expected to tone down the extent of its quantitative easing.

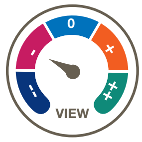
Looking ahead

Synchronised global economic growth, subdued inflation and strong corporate earnings are supportive for equity markets. Sentiment is positive, although it is a concern when consensus is as unanimous as it is today, with commentators and investors universally positive on equities and negative on government bonds. This does temper our enthusiasm for being overweight in equities – our positioning is more neutral, noting that few markets are cheap on traditional valuation metrics. We agree with the negative view on bonds, where we maintain our long-held underweight position. We continue to value diversifiers in portfolios, whether income generating assets such as property and infrastructure, or risk-reducing assets such as absolute return. These help to protect portfolios against geopolitical or economic risks that could upset the current calm and low volatility in investment markets.

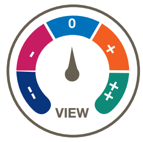
Current views



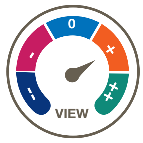
Equities



Bonds



Property



Absolute Return/Cash

Note: These diagrams are indicative of our asset allocation preferences.

Cazenove Charities is the largest investment manager of charitable assets in the UK. Supported by the investment resource at Schroders, the team of 25 charity specialists has a track record of generating strong risk adjusted returns with a commitment to responsible investing.