NEWSLETTER
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Strongbox
tailored wealth management

What should you be doing?

In our last Newsletter editorial, we wrote that it looked likely that inflationary pressures were rising in the US and the concensus of pundits was that the Fed was likely to embark on a policy of speedy monetary tightening – something that has been predicted and totally predictable since the GFC, but which spooked the markets as it could have led to recession just when growth seemed to be recovering globally.

But now it seems that we were wrong. After one of the worst quarters in the stock market since the GFC, January has seen a recovery driven by expectations that the Fed may not after all raise rates as fast as had been feared – on Jan 4th, Fed Chairman Jerome Powell said that he would adjust policy "quickly and flexibly". But why the change?

Well basically it seems that the economic recovery in the US that the Fed was relying on in order to be able to continue raising rates safely is not as robust as it was thought, despite the fact that the latest quarterly results have been generally good. Forward markets are again signalling expectations of low inflation and, outside of the US, gloom seems to be ubiquitous. The European Central Bank said recently that the balance of risks had moved to the downside - "the near-term growth momentum is likely to be weaker than previously anticipated."

The Bank of Japan also lowered its inflation forecast for 2019 by almost half a percent, and China recently reported its lowest annual growth – 6.6% - since 1990, with the second half of the year markedly weaker than the first. At the recent World Economic Forum in Davos, IMF Managing Director Christine Lagarde said "The world economy is growing more slowly than expected, and risks are rising.

(Cont'd on P 2)

Equities comment

Given the very fraught end to 2018, it is perhaps not surprising that the top performing holding in the Model Portfolio for the year was VIXY, our bet on market volatility which was up 66% in the year.

The second best performer was our Euro short position which showed a profit of 14%.

After all was done and dusted for the year, the top performing stock in the portfolio was CNOOC with a positive return of 6%.

Govt majority-held CNOOC is China's largest producer of offshore crude oil and natural gas and one of the largest in the world. The Group mainly engages in exploration, development, production and sale of crude oil and natural gas. The Group's core operation areas are Bohai, Western South China Sea, Eastern South China Sea and East China Sea in offshore China. Overseas, the Group has oil and gas assets in Asia, Africa, North America, South America, Oceania and Europe. As at 31 December 2017, the Group owned net proved reserves of approximately 4.84 billion BOE (barrel of oil equivalent.).

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Model Portfolio

The final quarter of 2018 was very volatile, with the S&P 500 down 9% in December alone, the worst December in the markets since 1931. However, for the whole of 2018 the S&P 500 was down by a much less dramatic 7.7%, and by mid-January 2019 it has recovered by 7.6%. So while it was a very bumpy ride, the end point was not much different from the beginning.

The model portfolio was down 16% in NZ$ terms in the final quarter of 2018, but down by only 6% for the whole year. We don't expect this volatility to settle down any time soon, and will be vigilant in selling any stocks we find are becoming over-valued.
No sales were made from the portfolio in the last quarter as we had sold most of our most over-valued holdings in the previous six months. One addition was made to the portfolio in the quarter - Lear Industries, which manufactures seating and wiring harnesses for the automotive industry.

Model Portfolio
Initial value $1m **Current Value** $2.11m
Cash 32% **Shares** 68%

Performance		**Bottom Performer Shares (ytd)**		**Top Performer Shares (ytd)**	
6 months	-7%	Indivior	-72%	VIXY	+66%
12 months	-6%	Micron	-39%	Euro	+14%
since start	+111%	Alaska Air	-17%	CNOOC	+6%

What should you be doing (cont'd)

Does that mean that a global recession is around the corner? No. But the risk of a sharper decline in global growth has certainly increased." So what's going on?

It seems that the structural issues that have dogged the world economy for at least the past ten years - "an aging work force in many of the biggest economies, weak growth in productivity, excessive global savings and industrial capacity, and a shortage of worldwide demand " (to quote the New York Times) - have – surprise, surprise - not gone away. And as long as these forces remain at work, economic growth will be precarious and very vulnerable to external shocks – like a Government shutdown for example.

Uncertainty like this makes investors nervous, and although equity markets are benefiting from these circumstances, we expect things to remain volatile. Economic uncertainty coupled with political uncertainties ranging from the Brexit shambles to Donald Trump's wall building project to increasing populism and extremism can be a very risky mix – it doesn't take much on the political front to cause markets to over-react to anything that is seen as bad news.

As always, we will be vigilant for good selling opportunities, and never give up looking for good stocks that the market has mispriced.

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