MelvilleDouglas
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Melville Douglas

Global Growth Fund - USD Global Growth Class

Fund Review

Over the quarter, the fund returned -0.8% compared to a benchmark return of +0.4%. The underperformance was attributable to the performance from the equity component, which underperformed due to its exposure to emerging market assets that sold off during the quarter. The performance for the balance of the fund, which is invested in global fixed income generated a negative return as bonds sold off and the USD appreciated. The fixed income return was very much in line with its benchmark.

Market Overview

After initially starting the year with strong gains, equity market returns have fizzled out. The prospect of another year of synchronised global growth appeared promising, but much of the good news was already reflected in asset valuations after a prolonged 'risk-on' period. Volatility, as expected, has picked up and looks set to continue as the year progresses.

Markets are now starting to discount both the fact that higher wage growth in the US poses a threat to inflation, and stricter monetary policy – a real concern for the valuations of risk assets that have benefited from an extended period of abnormally low interest rates. Furthermore, cyclical divergence between the US economy - fueled by tax cuts and investment spending - and most other countries has challenged the expectation that global growth will remain synchronised. These concerns are supported by a number of leading economic indicators, which are pointing to a possible loss in momentum outside of the US.

However, the slowdown in momentum is generally perceived to be temporary. Europe's economy, which is very reliant on exports and global trade, is currently adjusting to the impacts of a sharp appreciation in its currency and an overhang in inventory which resulted from the strong growth experienced towards the latter part of last year. Notwithstanding an increase in political risk and uncertainties related to the impact of Brexit and Italy, economic fundamentals remain positive. Consumer spending supported by employment and income growth, remains robust, consumer sentiment and business confidence are at historic highs, and high levels of capacity utilisation bodes well for investment spending. Expectations are that growth should rebound during the second half of the year.

The recent escalation in protectionist rhetoric and actions does not bode well and is already showing signs of inhibiting investment spending. The Trump administration is in the process of implementing a 25% tariff on $50bn of Chinese imports from 6 July. President Trump has indicated that the US will implement further tariffs should the Chinese retaliate. He has proposed an additional 10% import tariff on a further $400bn of imports from China. Effectively, this works out to be an effective 12% rate on $450bn of imports. He also indicated that his administration is considering implementing 25% tariffs on all imported vehicles and vehicle parts - worth an estimated $340bn - and further announced plans to introduce restrictions of Chinese foreign investment on "strategic" sectors in the US. These proposed tariffs are in addition to the tariffs already implemented on steel and aluminum imports from Europe, Canada, Mexico. These three trading partners vowed to impose 'dollar-for-dollar' retaliatory tariffs on the U.S.

We cannot be certain that any of the new proposed tariffs will be approved by the administration in Washington, and even so, will take significant time before they are implemented. However, the risk for investment markets is that trade relations are harmed to such an extent that large-scale economic damage is done, even though economists estimate that the direct cost to the global economy will be less than 0.5% should all the proposed tariffs come to fruition. The indirect impact will be less measurable, but tariffs impose a cost of doing business that will raise required rates of return and thus undoubtedly will affect businesses' profitability and willingness to invest.

Quarterly Commentary as at 30 June 2018

Looking Ahead

Both the prolonged economic and stock market cycles would appear to be entering their final chapters and therefore investors should tread more carefully and expect future returns to be lower and more volatile than what they have been accustomed to over the past few years. However, despite a softer economic backdrop during the first half of this year, apprehension in emerging markets and trade fears, the medium-term outlook for global economic growth remains favourable and is still expected to exceed long run potential output, whilst inflation looks to pick up only moderately. Our work shows that rising economic uncertainty and the trade spat have reduced the price investors must pay for some quality businesses and as such some attractive long-term opportunities are arising. In addition, there are plenty of companies that will be completely unaffected by trade issues, direct or indirect. We therefore remain with neutral weighting to Equities and expect them to still deliver superior returns to other asset classes.