

THE AUSTRALIAN

'Heightened risk' is the one definite for 2017

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Usually at this point in any given year, we begin to think about the year to come, where it might be heading, how we might prepare and what the changes could mean for us individually.

There is only one attribute that is clear as a bell for 2017 and that is “heightened risk”.

In several respects, this is actually desirable and a positive reality for global investors.

The primary scenario that really harms core portfolios is complete ambivalence towards ratcheting up risk factors or being unprepared and then blindsided by market events or shocks.

Before now and 2017, we have a US presidential election, which however it unfolds will most certainly see a pivotal shift in North American economic as well as political dynamics.

Therefore, remaining mindful of this unusual investment window across US markets, the question ultra high net worth global investors are rightfully asking is, if not the US, where else remains viable as a stable and robust developed market alternative?

On this, Charles Gave of Gavekal Economics recently noted: “One should concentrate one’s exposure in those countries that historically have shown they can manage such root and branch political transitions peacefully while maintaining both democracy and the rule of law.”

Gave adds: “There are very few of these countries, and funnily enough they all have pictures of the Queen (of England) on their banknotes.”

Regarding other European market alternatives, 2016 has been characterised by lacklustre global GDP growth and downward revisions to growth forecasts and 2017 doesn’t appear to pivot from this.

With persistently low inflation and little sign of a reversal of the unconventional monetary policies in Britain and Europe, rates remain at historical lows and the

now clichéd but dangerous, “lower for longer” rate environment and the search for yield can mean more harm and more foul.

Consequently, for Europe as an investment consideration for Australians seeking international return profiles, elevated levels of single-stock correlations across that continent’s equity markets are stuck in what has been dubbed a “fat and flat” range, and again it should remain a worry for any 2017 pivot or reallocation.

Regarding other asset-class alternatives such as energy market exposures, since the oil price correction in 2014, driven by cost overruns, poor execution and low growth, little appears to be any different heading into next year.

Efficiency improvements in US shale — now requiring about oil at \$US55 a barrel to break even — and rising production from low-cost producers in OPEC continue to push the oil cost curve lower. OPEC output is up 3 million barrels a day in two years.

On a positive note, with several citing an oil price uplift moving towards an average above \$US60 a barrel for 2018, companies with growth, capex flexibility and the potential for meaningful cashflow generation in Europe could very likely be Shell, ExxonMobil, Total and ENI.

And of course there is China.

China remains in a holding pattern of steady growth and cautious policy ahead of the 2017 party congress.

While China probably will not be forced out of the holding pattern, financial stress and structural problems continue to build and as an international participant focusing evermore closely on “return of” as much as “return on” investment, 2017 doesn’t present any new, at least obvious, stepping points back into the world’s largest new listed market.

Ultimately, equity performance reflects management’s capability to generate return on equity, which in turn is a function of earnings growth: China is no different.

The divergence between “new” and “old” China could not have been more striking in this regard.

Homing in towards what we afford credulous, the best economic tool that remains reliable to assess — at least as external and foreign participants viewing all from

outside the iron curtain — is what is referred to as the “money stock” or money supply.

Money stock is, at its simplest, the total amount of monetary assets available in any economy at any specific moment in time. It gauges the total quantum of currency in circulation, demand/bank deposits, money market funds and almost all in-between.

Granted, Communist China exhibits a uniquely proprietary mix of onshore and offshore currencies in conjunction with elements of open market microstructure juxtaposed right next to authoritarian, almost Orwellian-like capital controls but all in all, the economics remain the same and accepting these nuances affords the global investor one such opportunity to find their own sure-footed guide.

As previously discussed in depth, it is no secret that China’s ruling CCP desires developed market architecture and stature that comes with it by 2021; the 100-year anniversary of the genesis of the Chinese Communist Party. This hallmark is sometimes referred to as “The Chinese Dream” and accepting this, it may not come as a surprise to see China’s CSI300 “restoked” by government-supported market participants in early 2017. Predicating every forthcoming year following the “great recession” has been difficult but 2017 appears to be the toughest yet.

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