ALGO PERFORMANCE FUND

InvestEdge UCITS SICAV

January/February 2019

Fund Manager Commentary

Alternative Economic Policy & Alternative Assets

Peter Hollins
Director and Member
of Investment Committee

Early January, the US Federal Reserve Bank, signalled an end to the three months of 'tightening' of economic policy that had taken place towards to end of 2018. The tightening had prompted markets to sell off sharply in November and December, and so it rallied hard following the announcement. The US is now up 11pc year to date, with some 46 weeks of the year left to go.

Economic growth is stalling. We have zero interest rates, vast piles of debt built up from three successive waves of Quantitative Easing, yet growth is stalling. It seems as if each successive wave of monetary easing has had less of an impact than before. Economies are on a slower and slower growth path.

Some commentators imply that another round of easing is being discussed: QE4. But would it have any impact? And can the world afford yet another QE programme, added to all the others?

Another issue is more of a social one. Vast quantities of capital injected since the financial crisis of 2008 were intended to keep economies functioning and prevent a 1930s style depression with mass unemployment. In one respect this was achieved. But modern business uses technology and globalisation of supply chains to propel profits, rather than use capital. Indeed, the emphasis is on keeping wages low, rather than generating more volume. The QE increase in capital earmarked for economic expansion has not been used to drive wages, it has been used to drive up asset prices instead.

Essentially the problem with zero interest rates is that old companies, weighed down by debt, can continue to limp along. A huge debt burden is easy to service if it costs little. Margins can be tiny. These inherently unsuccessful businesses would fail in a normal environment. Zero interest rates prevent the normal business cycle from functioning: Darwinian natural selection of businesses is prevented. It is almost as if Dinosaurs had been kept alive long after the extinction event.

This is the problem with the discussion of more QE. If we are heading for a global slowdown with zero interest rates now, then clearly, by definition, Quantitative Easing is no longer a viable solution.

What we need, sooner or later, is to normalise economic policy. This means interest rates rising to at least inflation levels. Debt needs to be reduced, taxes increased.

Will this lead to companies failing? Yes. But then, any company which cannot cope with 2pc interest rates is hardly worth keeping going. Better to let it go and replace it with something more vibrant. Mass unemployment is unlikely to follow. The problem, for many, lies with the unwinding of asset price inflation. Property prices will fall, equity prices will fall, bond prices will fall. But this is, in some areas, beginning to happen anyway. Property prices are stalling because people do not earn enough to cover the inflated prices. Equity values will become undermined by the economic slowdown, investors will thus demand better returns (i.e. from lower prices).

The sharp rally in all investment classes since the start of the year has been at odds to the general economic slowdown. It is even more at odds with the reality that there is little left for Central Bankers to stop economies slowing further. Afterall, if bonds and equities can rally sharply at the same time, they can certainly fall at the same time.

Traditional portfolios stand at higher risk this year as opposed to 2018 and new, alternative investment instruments will be needed. Firstly portfolio risk needs to be balanced with assets offering fewer correlated returns. Secondly, good timing to escape the tsunami impact of a Quantitative Easing hang-over.

Our Fund, is especially well placed as an Alternative in these times of economic and political turmoil, and we believe will benefit our investors in times of volatility in the global markets. Noting our steadiness during the market drop in Q4 2018, we remind our investors that the Fund is uncorrelated to the standard asset classes and over the last six months has decreased leverage and increased liquidity and therefore is particularly better poised in 2019 to take advantage of volatility moving forward.