

LETTER FROM EDOUARD CARMIGNAC

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EDOUARD CARMIGNAC'S LETTER

Edouard Carmignac writes on current economic, political and social issues each quarter.

Dear Investor,

At the time of writing, a number of observers are inferring from Donald Trump's unhinged campaign that the populist wave seemingly on the brink of overwhelming Western democracies is on the way out. I, for one, consider that highly debatable. I also fear that our values and well-being are under attack.

For one thing, the Republican Party's very choice of a candidate so egregiously unqualified to head the world's leading power is cause enough for concern. For another, UK prime minister Theresa May's rush to push Brexit through leaves us scratching our heads. And then there's the no less disturbing popularity of extremist parties in France and Germany as both countries gear up for crucial elections.

What do these various populist currents have in common? The discontent generated by an ailing global economy has flared into widespread distrust of the elite and a growing urge for citizens and communities to turn inward. Foreigners are conveniently being blamed for job erosion – both as low-wage immigrants and as low-cost exporters. How do populists propose to address such problems? With a mild dose of protectionism, if possible accompanied by currency depreciation, so that governments can spur growth via deficit spending and give nominal wages a boost – which would soon be wiped out by rising inflation, of course. Many of them would also throw in stiffer taxes on capital for good measure.

But even if such populist programmes are implemented only gradually, and perhaps in watered-down form, we feel it is wise to factor them into our investment approach as of today. A return to fiscal easing, alongside the ongoing monetary easing which has already provided as much stimulus as it can, will bring about a larger supply of government paper – just when even a moderate increase in inflation is bound to curb investor appetite. We will therefore be taking a cautious stance on developed-country sovereign bonds. After a more than 35-year bull run that has kept their prices up, they now have little more value to offer. In contrast, equities stand to gain from accommodative fiscal policies, which would reassure investors about economic stability, provided that interest-rate hikes don't get out of hand. This scenario of less erratic growth, coupled with a pick-up in inflation, is likely to put commodities – first and foremost oil and, as usual, gold – at an advantage over stocks with “good visibility” that have in recent years been among the main beneficiaries of a feeble economy and ultra-low interest rates.

The advent of a new economic and financial order is seldom plain sailing, given that investors are easily wrong-footed by major challenges to the market consensus. However, by proactively reshaping our portfolios in response to new developments, we should be able to reduce volatility in the current transition phase and subsequently generate value from it.

Yours truly,



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