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Financial Planning News
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WHEN ECONOMICS MEET POLITICS

Fund managers have historically taken little notice of potential political outcomes when building their investment portfolios and in our fund research, we have seen little evidence of value being added to portfolios over time through trying to forecast these types of events. Fund managers talk about "ignoring the noise" and focusing on the fundamentals impacting a specific asset or asset class, rather than who wins an election or any tweak in government policy. The theory is that good businesses have found a way to work through changes in the political landscape.

And even if one were able to call a political outcome correctly, positioning portfolios to benefit from that call is very difficult with the impact the outcome has on markets often very different to what was expected. The perfect example was the US presidential election in 2016 when Donald Trump was elected: the majority of investors agreed before the election that a Trump win would be negative for investment markets, but the opposite materialised with markets up strongly post the election.

However, it appears that politics has become far more entwined with economics in recent years and political decisions are starting to impact directly on economies, equity and bond markets, business sectors and even specific companies. So, is it really possible to focus purely on the fundamentals of a particular business - its earnings, its growth potential – without thinking through the impact politics may have?

This is best illustrated by three current political events that have had, and continue to have, an impact on businesses, industries and markets.

TRADE WARS

President Trump won the 2016 US election on the back of his populist promise to "Make America Great Again". A big part of following through on his slogan was his attempt to right what he regarded as an imbalance in global trade. In his view, China (and others) were getting a better deal than the US in their trade dealings. The result was the US (Trump) imposing tariffs or duties on a broad range of Chinese imports into the US. This was effectively the start of a Trade War as China retaliated by imposing their own tariffs on select US imports.

Tariffs can have devastating impacts on businesses and entire industries. The US soybean industry is a great example. In 2017, China bought about 60 percent of US soybean exports in deals valued at more than $12 billion. In retaliation to the US tariffs, Beijing imposed a 25% tariff on US soy shipments in July 2018. The impact was immediate and far reaching for the US soy industry - China did not import a single US soybean in November 2018. Zero. A political decision destroyed 60% of the industry's export market.

While that is at a micro industry level, the Trade War has had a broader impact by helping slow global growth and changing investor's sentiment to one of increased caution regarding equity markets. The caution isn't only short-term noise that can be ignored, rather there are long term concerns that lower global growth will impact on the earnings of businesses and their share prices.

The market anxiously waits for clarity on the outcome of the trade talks currently taking place between China and the US. Any news about the likely outcome immediately shifts investment markets. While this may all be short term news flow and market reaction, there will be significant long-term impacts on businesses, industries and markets depending on the outcome. If the trade deal results in additional tariffs, it will be negative for investment markets. These talks and the decisions reached are political in nature but have material impacts on global growth, company earnings and investment returns.

BREXIT

Brexit is proving to be an unmitigated disaster for the UK. On 18 January 2017, the front-page headline of the Times newspaper in the UK read:

"May to EU: give us fair deal or you'll be crushed"

After more than two years of in-fighting and political manoeuvring within the British parliament, the picture is much changed with the Times' headline on 9 April 2019 reads:

"May pleads with Merkel to be given extra time"

How times have changed, and the prolonged political posturing has been detrimental for both the UK equity market and the UK currency. The long-term ability of UK based companies to grow their earnings and produce returns for investors is being heavily influenced by a political decision-making process. It is very difficult to believe that analysing businesses with no regard for the Brexit outcome will provide all the answers for managers of investment portfolios. The share price of many UK businesses appear very cheap relative to their history, but if a no-deal Brexit were to eventuate there is an argument that they are cheap for a reason and will remain so.

The latest development with Theresa May announcing her resignation just adds additional confusion and debate around the Brexit debacle. We all wait to see how the next chapter unfolds!

SOUTH AFRICA

With South Africans having recently been at the polls, the political narrative playing itself out in the country is an uncertain one. The outcome of the election didn't deliver too many surprises at a national level with the ANC retaining its majority at 57.5% of the vote. However, the uncertainty centres around which ANC will emerge in the aftermath of the election. Will Ramaphosa prevail and implement growth based economic policies while continuing to rid the state of corruption? Or will the Zuma-friendly faction manage to oust Ramaphosa in the wake of widespread rumours of potential prosecution of the faction's ring leaders? Or will the answer be somewhere in between with the ANC hobbling along, hamstrung by infighting between the factions and a continuation of mixed government policy?

A Ramaphosa led "new dawn" with a small cabinet and reduction in the cost of running government, a strong anti-corruption stance (including a few high-profile prosecutions) and a renewed social compact between government, business and labour would be expected to be positive for investment markets. This would be exacerbated for shares that rely on the SA economy and the SA consumer for their revenue, who are currently struggling and trading at very cheap levels compared to their history.

If the Zuma-friendly faction were to prevail, sentiment from foreign and local investors alike would be extremely negative. One would expect the Rand to depreciate materially against all currencies and to see significant outflows out of both the equity and bond markets.

Once again, the outcome of a political process will have a material, long term impact on investment markets. While understanding the underlying drivers of the individual companies and shares is still crucial to constructing an investment portfolio, it is clear that the big political calls will have a material impact on the long-term ability of those companies to deliver on the expected revenue and profit targets.

JACKIE LEAVES US TO TAKE ON A NEW CHALLENGE

It is with regret that we have to let you know that Jackie is leaving us at the end of June to pursue a new challenge.

Many of you will have dealt with Jackie over the years. She has been an integral, positive part of our team and her enthusiasm and infectious laugh will be missed.

Jackie has an opportunity to become a full time student and is going to be studying linguistics at Stellenbosch and before that is taking some time to visit her family in Ireland.

We wish Jackie all the best in her new chapter, the Steward Capital team, and I'm sure many of our clients, will miss her!