MAN GLG CIO COMMENTARY

2019: THE REVOLT / REVOLUTION CONUNDRUM

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INTRODUCTION

As is traditional at this time of year, we have spent the first weeks of January meeting with strategists from a host of different institutions – some large, some small – as we seek to build up an idea of the general mood music of the markets. Whether we chose to agree with this consensus is quite another matter, but it's useful to have an indication of the broad mindset of those whose words are read by, and influence, so many.

Our meetings at the beginning of 2019 have been characterised by an almost comical lack of agreement. Once we tallied up the various outlooks from our several weeks of meetings, we ended up with a precise split: a third bullish, a third neutral, a third bearish. This very lack of consensus amongst analysts is itself an indication of the febrile state of the market's communal psychology – more interesting, perhaps, than the analysts' research itself.

'IS IT A REVOLT?'

There's a famous exchange between Louis XVI and the Duc de la Rochefoucauld a couple of days before the storming of the Bastille. "Is it a revolt?" the king asked. "No, Sire, it's a revolution," replied the nobleman.

I often bring this to mind as a useful thought exercise, a prompt to take a step back and seek a wider perspective on things. Perhaps the reason that strategists – and the broader market – appear so flummoxed is because there is a dawning recognition that questions about where we are in the current cycle are more or less irrelevant in a world so dominated by political risk. And perhaps what appeared at first a revolt against globalisation could be a revolution.

It could be that 2019 sees the beginning of widespread acceptance of the idea that we have moved into an entirely new paradigm as far as the global macroeconomic picture goes. Donald Trump, Brexit, the Gilets Jaunes, Lega-M5S, far-right regimes in the Philippines, Brazil, Poland and Hungary … all of these are symptoms of a wider secular shift whose general direction we can discern – less globalisation, bigger budget deficits, less independent central banks, an end to austerity, pressure on margins, more taxation on what Theresa May called the "citizens of nowhere" to pay for tax cuts for the "citizens of somewhere", increasing popular protest and unrest. What is harder to ascertain is the scale, duration and direction of these changes, and, crucially, how to price them.

We spoke a great deal over the course of 2018 about where the market was in the current cycle, about Elliott Wave Theory and the various pressures being exerted upon equity pricing. As the year drew to the close, we became more pessimistic in these columns and allowed ourselves a quiet pat on the back when the volatility we'd predicted for year-end arrived with such force. What we are decidedly not doing now is making any predictions for the year ahead. Rather, we believe that it is time to take a step back and ask ourselves serious questions about whether the market as a whole has been unable to see the wood for the trees.

It's not hard to see why analysts were so divided in their views; every potential pitfall has a concomitant upside. Brexit is the perfect example of how unpredictable events have become. The range of possible outcomes is absurdly wide, from the chaos of a disorderly no-deal to the relative calm of a Norway-style agreement to the prospect of no Brexit at all.

Similarly, President Trump is nothing if not capricious. What's more, he's extraordinarily focused on the level of the S&P 500 Index. He needs the market to rally and whilst he's been helped by the Federal Reserve blinking first and rolling back the hawkishness of their tone in the wake of December's rate rise, it would not be a surprise to see a US/China trade deal in the near term. Finally, while Europe's economy appears to be stagnating, the possibility of stimulative intervention by the European Central Bank looks increasingly likely.

Britain has quietly abandoned austerity and French President Emmanuel Macron responded to the Gilets Jaunes with a giveaway worth more than EUR10 billion – equivalent to 0.4% of GDP. Allied to the already-mandated EUR4 billion to cancel the fuel tax hike, this looks like pushing France's 2019 deficit to 3.4% of GDP, with debt-to-GDP rising to more than 100%. Indeed, if France ends up with a 3.4% deficit, how long does Europe think Italy will stick to a budget deficit target of 2.04% of GDP this year?

With the US budget deficit creeping steadily higher and now close to double the figure from Barack Obama's last year in office, it feels like governments may be resigned to spending their way out of trouble. We say it again – depending what perspective you decide to take, things can look enormously bleak or relatively promising.

CONCLUSION

Given the murkiness of the overall picture, we here reiterate our well-practiced mantra of favouring uncorrelated long-short strategies bolstered by intensive bottom-up analysis. Clarity will, we believe, emerge eventually, even if we are witnessing a revolution, not a revolt.

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