HOVING & PARTNERS
WEALTH MANAGEMENT

The Inside Track

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- **The global economic outlook is deteriorating**, while a combination of (1) **global debt overhang** and (2) **rising tensions** (not only trade) between the US and China is imposing a hard ceiling on any possible upside. Total non-financial debt at USD167tr - equivalent to 250% of global GDP and 54tr higher than in 2008 - creates all sorts of specific debt-related vulnerabilities across countries. Furthermore, the negative consequences of a more adversarial relationship between the world's two dominant economies are starting to be felt in terms of global sentiments, demand and investment flows.

- In a rather under-noticed speech earlier this month, US vice-president Mike Pence delivered what amounts to a declaration of cold war against China. Following a series of official statements, it marks a fundamental inflexion point: the Trump administration has brought the 40-year period of US strategic engagement with China to an end, **replacing it with strategic competition**. Nobody can know how long this new era will last and whether it will evolve into something more serious: decoupling, containment, confrontation, and even, possibly, a war. What is certain is this: **increasingly, countries will be asked to take sides**, as apparent with the new NAFTA agreement (USMCA) that bars Mexico and Canada from seeking a separate trade deal with China.

- More broadly, **the era of "patriotic capitalism" is upon us**. As inter-state competition and rivalry rises, countries all around the world will favour their national champions well beyond the military and tech industrial complex: the broader manufacturing supply chain and any "big" business (like in food & beverage) will be strategically repositioned at the intersection of economic and national security. The most direct consequence: **there'll be more state interference in business** and insourcing will become an important issue.

- Almost all equity markets had a horrible month. As always, there isn't a single catalyst, but rather **a host of triggers - unnerving investors as they conflate with each other, amplifying risks**. Now that the markets are no longer driven by liquidity, concerns about fundamentals relate to: (1) rising interest rates; (2) global economic growth losing momentum; (3) China's ability to continue growing while dealing with its debt; (4) Italy's fight with the EU; (5) trade tensions; (6) peak US earnings; (6) and the political / geopolitical mess that besets a very large part of the world.

- **Jamal Kashoggi's murder is a monumental setback for Saudi's economic reforms**. For all the hype about crown prince MbS's "vision", foreign direct investment into the kingdom plunged by more than 80% between 2016 and last year – from USD7.45bn to 1.42bn. The government target to attract USD18.7bn by 2020 is therefore dead in the water. In the meantime, capital flight – a reflection of a lack of confidence – amounted to USD80bn last year and will probably reach USD65-70bn this year. These are ominous signs. **MbS**, as one academic put it, **"has done an impressive job of consolidating power and a miserable job of using it"**. Without foreign capital and investments, it's hard to imagine who will carry out the reforms that Saudi so badly needs.

- This month, there are two unsettling bits of news about Europe. (1) **The showdown between the EU and Italy over its budget**. Even if a deal is struck in the next three weeks (the most likely outcome in our view), anti-EU sentiments have risen and are now entrenched – together with anti-migrant sentiments. (2) The grand coalition setback in the elections in Hesse marks the end of Merkel's 18-year era. **Germany's political centre is imploding**, leaving the country adrift.

- With the election of Bolsonaro - the first far-right president since the end of the military dictatorship in 1985 - **Brazil becomes the latest country to turn away from liberalism and to coalesce around the rule of a strongman**. Thus joining the club of China, Russia, the US, India, the Philippines, Turkey, Hungary and a few others. The first consequence of the rise in global populism is the promotion of an economic nationalist agenda, for which there is a consensus among the far-right and the far-left. **De-globalisation is coming**, hurting first businesses with intricate, complex supply chains. Investors ignore this risk at their peril.

- It is often said that **technology destroys jobs but not work**. True indeed. Many new jobs are being created beyond tech. **"Pet wellness" – a fast growing business – is one such example**. Although why some of us (in increasing numbers) treat our animals as if there were humans is not easy to explain, **the investment case of anthropomorphism is unquestionable**. This year, pet spending in the US will exceed USD72bn, while in China it will increase by 50% (over 3 years: from 2016 to 2019). 40% goes towards the progressive "humanification" of food (we can now buy pumpkin-spice lattes for our dogs…), but pet grooming and boarding is an expanding proportion of that amount (around a tenth). Spas for dogs and cats are now becoming common, and so are dog tuxedos and bow ties for weddings!

- **The latest IPCC report on climate makes grim reading**. Its overarching conclusion is that every fraction of a degree of warming matters; and that if we want to limit global warming to 1.5 degrees Celsius (2.7 Fahrenheit) in the hope of averting catastrophe, we have as little as 12 years to act, which requires slashing global emissions by 45%. For investors, this means the following: (1) **a tax carbon combined with heavy regulation is inevitable**; (2) progress in the use of non-fossil fuel technologies will continue to advance exponentially rather than linearly, with sustainability embedded in all decisions.

- The digital divide is going into reverse. **Until recently, it was all about access to technology; but now it's about limiting access to technology**. Among those who know most about tech, the worry about the impact that digital devices have on their children is such that they are moving towards a complete or partial ban. In the Silicon Valley, elite schools now eschew most digital devices while schools for poor and middle-class children continue to promote screens. Moving forward, this is a sign that businesses and ideas focused on human interaction will benefit from a premium.