Like the notoriously fickle Goldilocks of fairy tale fame, markets love it when things are “just right”. Take economic growth, for example: more is always better, isn’t it? Not necessarily.

Too much growth, at too rapid a pace, can result in what economists would call “overheating” – the economy is simply too hot. Unchecked economic growth can lead to a spike in inflation and suddenly much higher prices. Wages quickly start struggling to keep pace with a higher cost of living, savings become depleted, and so on. What’s more, the world’s central banks start to raise interest rates, to slow the wild spending party and generally dampen the mood.

On the other hand, of course, an economy that is moving too slowly will see job losses, home and business foreclosures, and a significant slowdown in consumer spending and confidence. If an economy has a negative growth rate two quarters in a row, it’s officially in recession.

At time of writing (early June), we are somewhere between these two scenarios. Global economic growth is steady, if not spectacular, while central banks such as the US Federal Reserve and the Bank of England have indicated they will not be increasing already historically low interest rates any time soon. But is this a true Goldilocks scenario? At the risk of over-extending this metaphor, we might say there are some potential lumps in the porridge.

The first, and perhaps least predictable, is the geopolitical landscape. The ongoing spat between the US and China over trade tariffs is a key factor, affecting not only those two massive economies, but pretty much the global economy, in the view of the International Monetary Fund (IMF). In the latest escalation of the US-China trade dispute, the US raised tariffs to 25% on $200 billion of Chinese imports, prompting China to take retaliatory action. The IMF says the impact will be felt by both consumers, who will have to pay more for imported goods, and importing firms who may suffer a squeeze on profit margins. The IMF estimates that the trade dispute will reduce global economic growth by 0.3% in the short term. However, it expects a pick-up in global growth in the second half of the year, supported by a more accommodative monetary policy stance by major economies.

Europe has its own political concerns, with Italy once again clashing with the European Commission on the country’s level of public borrowing, which could unravel the compromise struck late last year. And of course, here at home, the results of the European Parliamentary elections and the announcement that Prime Minister Theresa May will be stepping down presented renewed potential for a no-deal Brexit.
Next, there are a few technical indicators in global markets that don’t necessarily suggest a recession is imminent, but do give us some points to consider. The most liquid monetary supply (‘M1’, which includes currency and highly liquid assets) has been nearing lows last seen in 2008, indicating the end of a supportive fiscal stimulus cycle. Corporate profits are facing increased pressure, while corporate debt is piling up at pace. In broad terms, US corporate earnings for Q1 2019 were flat, although they were better than expected and the trend in earnings revisions has turned up. Of more concern, according to Moody’s Capital Markets Research, is shrinking cash on US corporate balance sheets and rising corporate debt, which has reached a record level of 46.6% of US GDP.

The gap between US economic performance and the rest of the world could be narrowing, and the yield on the 30-year US Treasury bond fell to a near two-year low in the last week of May (meaning prices moved higher on increased demand), suggesting Wall Street, and investors more generally, may be growing concerned about the US economic outlook.

Overall, we believe these factors are more likely to be headwinds for global growth, rather than harbingers of recession. Trading could become more volatile in the second half of 2019, as investors react more skittishly to daily developments. It’s important, however, to remember the difference between a trading and an investing mindset. Traders react in the short-term to price fluctuations and shifting sentiment – “trading on news”, as it’s called, but more often than not, they’re trading on what they think the news might be. Investors, on the other hand, are in it for the long-haul.

We have a long-term, multi-asset perspective - we don’t react to short-term news but do, at times, view price fluctuations as potential opportunities for our funds to purchase selected assets at lower prices. While we monitor market developments daily, we adopt a long-term investment strategy, which we think is the best way to help our customers plan for their futures.