R.C. BROWN
investment management plc

MARKET COMMENTARY NEWSLETTER

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New for 2019

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In previous editions of our newsletters, we have focused on what we can offer your clients, by way of expertise, market access and service. This time we are focusing on what we offer to you as Advisers, and how this might help you shape your business and client proposition. Let us know if you would like to discuss any of these further.

Direct access to Investment Managers
- You and your clients have the direct phone & email details of whoever is managing the portfolio, so you can easily obtain as much detail as you require.

Online and/or paper application forms
- We have developed an online version of our paper forms, both of which are available via our website (https://www.rcbim.co.uk/professional-advisers/).

Online access to client valuations, transactions & reports
- Again, via our website, you have secure access to individual client portfolios right down to transaction level (https://www.rcbim.co.uk/adviser-login/).

Managed Funds or Direct UK Equity portfolios
- We don't believe one size fits all, so all portfolios can be individually traded if needed. We do however subscribe to the belief that we share the best ideas across as many portfolios as possible, so the component assets can look very similar irrespective of the objective or risk appetite.

Ethical Portfolios
- We don't preach what ethical or socially responsible investing is, we listen to what your definition is and build portfolios accordingly.

AIM / IHT Portfolios
- We have been active in the AIM market for over 20 years, so understand the constraints and pitfalls, but following a specific client request have created an IHT friendly portfolio service.

Transparent choice of fee structures
- We try and keep things as simple as possible, so have always quoted our fees inclusive of transaction & admin costs. We have even gone one step further and created a Fee Calculator on our website (https://www.rcbim.co.uk/fees/) that shows ALL costs incurred and a choice of fee options.

'Hands on' portfolio service from £15,000
- We believe that proper management of client money should be available to all, therefore whether your client is just starting out with an ISA or has accumulated wealth over the years, we will give you both our full attention.

White labelling
- Whether you have your own asset allocation model or subscribe to ours, and can commit £10m+ of client portfolios, then we can help you brand your own investment proposition that is managed by us.

MPS on 'in-house' Platform
- If you are looking for a less bespoke approach, but still want the 'hands on' investment service (and can commit £5m+ of client portfolios), then we have an MPS service available on our own in-house platform.

Independently assessed for Due Diligence
- We know that you can't just take our word for the level of service & expertise that you and your clients will receive, so we have obtained 3rd party independent confirmation
  - 5 star rated by Defaqto
  - Full 3D accreditation from ARC

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The World According to Glenn………….

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In a futile attempt to stop me thinking about Brexit, trade wars and market volatility I have recently found myself conducting some simple thought experiments on modern monetary theory (MMT). I know that makes me sound like a sad (insert chosen expletive) with too much time on his hands, but thought experiments can be a useful way of testing a hypothesis without doing any material harm to the real world. For instance, imagine the outcry from animal lovers if Schrodinger had experimented in real life to find out whether his cat could be simultaneously both alive and dead. And, given the uncertainties created with the widespread introduction of unconventional monetary policy, perhaps a thought experiment is the least harmful way of working out answers to important questions such as "how did we get here?" and "where are we going?".

So far, I have been doing my thinking when driving back and forth to the office. My simplistic model of the global economy hasn't taken up too much of my limited thinking skills and I've also managed to keep the car on the road and arrive safely at my destination. Some of you may recall that in previous newsletters I have been exercised by the apparent breakdown in both the Phillips Curve and NAIRU, before testing the hypothesis that the relationship between unemployment, wage growth and inflation is of less (or minimal) importance when interest rates are stubbornly close to zero. Anyhow, somewhere around the Hungerford turnoff going west on the M4, (with Mick and Keef turned up loud and singing Route 66 I misheard the words "Well if you ever plan to motor west, just take my way, it's the highway that's the best. Get your kicks on Route M4 West") I had a thought. Well, the germ of a thought really and nothing like a Damascene moment (that was a different road altogether) that said something like "If the government never needs to default on its sovereign debt in its domestic currency" (this is the central tenet of MMT) "because the central bank can print enough money to pay the interest on any amount of government bonds that may be in issue. Then government debt can be infinite". But what of the opposite position; "Can government bond yields indefinitely be held at zero and maintain positive demand?" This is, in effect, an example of testing the Ricardian Equivalence hypothesis through *reductio ad absurdum*. For those for whom the equivalence hypothesis may have slipped from immediate recall, David Ricardo tried to work out whether it was better for a government to finance a war through immediate taxation or to issue bonds with infinite maturity and annual interest payment of £1m. He assumed a need to raise £20m, if this was taken from taxation there would be an immediate hit to consumption. If the finance was raised by issuing bonds at an interest rate of 5%, he concluded that the two options had an equivalent value, making the choice tax now or tax later. However, it follows that if interest rates are at zero, debt could be infinite as the debt servicing costs are zero.

When pondering this thought I had to swerve sharply to avoid hitting the overhanging branches of a magic money tree that had sprung up on the central reservation. And it seems to me there are central reservations on both the M4 and in MMT. Anyway, this tree seemingly was rooted in well-rotted mushroom compost, the type used to keep people in the dark while feeding them on digested organic matter. But my reservation was that for the roots to become well established, so that the tree could bear fruit for many years to come, a healthy top dressing of inflation would need to be added to the soil. But of course inflation is not necessarily an issue in MMT, because the private sector's demand for money can become infinite in order to pay for infinite growth in goods and services. However, should prices begin to rise because the supply of money has grown faster than the output of the economy, then MMT has an answer in the form of NAIBER (the non-accelerating inflation buffer rate of employment). This catchily titled acronym simply says that there can be an in-built control mechanism for inflation by having the state act as an employer of last resort by offering a job guarantee in order to create full employment and price stability. Holy moly! If this is true, in one short trip it seems that MMT has postulated economic nirvana and we can all look forward to jobs for life. After all, in another famous thought experiment testing the effect of the Keynesian multiplier, it was postulated that it would be economically beneficial to take two groups of unemployed workers and pay one lot to dig holes before paying the second lot to fill them in. On a pure national accounting basis this works just fine, but in the world where I live it only half works, depending on whether I want a hole dug or filled in. Nonetheless, the wages paid to dig or fill in holes create incremental demand and any inflationary effect, where prices would tend to be pushed up when demand approaches the output capacity of an economy, can be offset by raising taxes until demand and supply return to equilibrium. Logically the additional tax receipts can then be spent by the government to increase productive capacity and so reduce the need for under or unemployed workers to work as part of the job guarantee scheme that is inherent in the buffer rate of unemployment.

As a thought experiment NAIBER has attractions. However, maintaining a buffer stock of employed workers with no need to rely on state benefits (rather than a buffer of unemployed workers with high social costs) also has real world limitations. From the state's perspective, using workers as part of a price stabilisation mechanism (in the same way that commodity prices are stabilised by maintaining a buffer stock to balance inequalities in supply and demand) implies a degree of fungibility between workers that doesn't fit with the inevitable variety of skill and experience levels. Nor does it sit very comfortably among citizens in a democracy who see themselves as individuals rather than cogs in the machine of state. Potentially, a greater limitation will be the propensity for unemployed workers from abroad to move to a territory with a job guarantee scheme if unemployment is high in other economies. This may be controlled by restricting the movement of economic migrants moving from one sub-optimal economy to another sub-optimal economy (but one with a job guarantee) but even in post Brexit Britain I doubt that the UK will have fully closed borders.

In some quarters, Universal Basic Income is seen as an alternative to a job guarantee scheme but this will not add to the productive capacity of an economy and may also have the unintentional effect of drawing in additional under or unemployed workers who all demand payment. In writing this I'm conscious of sounding a little like Gordon Brown (heaven forfend) when he said his economic approach was rooted in post neo-classical endogenous growth theory, but the biggest obstacle to the effectiveness of MMT that I've thought of so far is the threat of exogenous factors. MMT may work well in a closed economy (or indeed in a thought experiment) but in a complex global economy with many different inputs, incremental supply of labour from abroad will bring down the wages in the job guarantee system to a level below the subsistence level. However, I concede that MMT can be useful as part of a policy agenda to be used in periods of acute demand deficiency if it is recognised that the state can only produce the amount of money that it wants if this is consistent with its inflation target.

The use of MMT to implement government policy has been seized on by some academics, environmentalists and politicians as a means of funding what is becoming known as the "Green New Deal". However, for this to work there would need to be spare capacity in the economy, deflationary pressures and a stock of unemployed labour. In the US (where the Green New Deal has gained most attention), there is virtually full employment and, although there is still hardly any upward pressure on wage rates, suggesting the Phillips Curve still isn't working, the risk of deflation taking hold in an environment where trade tariffs are going to have to be paid by the domestic workforce, seems low. Getting people to work to implement environmental projects at the wage rate set by NAIBER may be an act of altruism, but it does not fit the model of economic rationality. On closer examination, that magic money tree now seems to be wilting. Perhaps, if we are to put right past environmental damage there will be a cost. Paying that cost without driving down economic growth unfortunately remains a real challenge.

For now, it might be that my journey down the M4 and into MMT has truly gone west. Next time, any thinking I have to do will be done on the original Route 66, starting at the Chicago Booth School of monetary economics fame, taking in the University of Missouri (protagonists of the job guarantee element of MMT) and ending up at UCLA. Altogether now, *"get your kicks on route 66".*

Back in the real world, we have continued our policy of preferring equities over bonds and retained a preference for defensive and value exposure, rather than growth assets trading on high valuation multiples. With the yield curve on US Treasuries again being inverted there are some fears of a US recession in the next year or so. And where the US goes the rest of the world tends to follow. This is possible, but with 2020 being an election year we do not see President Trump doing anything other than adding as much economic stimulus as needed in order for him to increase his chance of being re-elected.

How we have performed (as at 31st March 2019)

RCBIM PERFORMANCE DATA SHOWN IS CALCULATED AFTER ALL FEES / COSTS

MANAGED FUNDS PORTFOLIOS

Risk category	Portfolio	3mths	12mths	3 Years	5 Years
Cautious	RCBIM Managed Funds	5.07%	0.36%	11.98%	19.64%
	ARC £ Balanced	4.56%	2.41%	15.12%	21.60%
Cautious Balanced	RCBIM Managed Funds	6.30%	0.61%	15.94%	23.72%
	ARC £ Balanced	4.56%	2.41%	15.12%	21.60%
Balanced	RCBIM Managed Funds	6.57%	0.70%	20.82%	27.74%
	ARC £ Steady Growth	6.43%	4.68%	22.78%	30.61%
Balanced Growth	RCBIM Managed Funds	7.46%	0.74%	20.79%	25.40%
	ARC £ Steady Growth	6.43%	4.68%	22.78%	30.61%
Growth	RCBIM Managed Funds	7.44%	2.31%	25.81%	33.64%
	ARC £ Equity Risk	7.88%	5.92%	28.34%	35.36%

DIRECT EQUITY PORTFOLIOS

Risk category	Portfolio	3mths	12mths	3 Years	5 Years
Cautious	RCBIM Direct Equity	4.88%	0.93%	12.04%	18.54%
	ARC £ Balanced	4.56%	2.41%	15.12%	21.60%
Cautious Balanced	RCBIM Direct Equity	5.72%	1.62%	19.29%	24.90%
	ARC £ Balanced	4.56%	2.41%	15.12%	21.60%
Balanced	RCBIM Direct Equity	6.96%	2.63%	25.66%	34.73%
	ARC £ Steady Growth	6.43%	4.68%	22.78%	30.61%
Balanced Growth	RCBIM Direct Equity	7.11%	2.57%	24.57%	30.55%
	ARC £ Steady Growth	6.43%	4.68%	22.78%	30.61%
Growth	RCBIM Direct Equity	6.88%	2.46%	25.79%	31.07%
	ARC £ Equity Risk	7.88%	5.92%	28.34%	35.36%

AIM / IHT PORTFOLIOS

	3mths	6mths	Since inception	12mths
RCBIM AIM / IHT Investment Service	7.16%	-14.13%	-2.58%	n/a
FTSE AIM All Share TR Index	7.03%	-16.03%	-12.35%	n/a

The RCBIM AIM / IHT Investment Service was created on 1st May 2018, so historic data is limited to that time period only