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Why I'm worried: I'm the only one worrying

There is something worrying me about the market at the moment: no one seems to worry to the same extent as me.

Saker Nusseibeh
Chief Executive Officer

The way the market seems to be perceiving risks appears out of kilter with what might easily transpire. True, there is some concern about an impending global trade war, but it appears limited, as if many believe the current tension will resolve itself with little negative fallout. Perhaps some imagine that President Trump is simply using hyperbolic language, or that he is using a negotiation technique of pushing to the extreme then allowing a turnaround, which is what he did with North Korea.

My worry is that conditions could deteriorate very quickly, which does not seem to be reflected in any measure of market risk at present.

My reasons are threefold.

Firstly, we mustn't forget that China is centrally controlled. While the country is using a partially free market environment to build its economy, it remains centrally managed and ideologically directed. It could decide to make a stand against what it might perceive as a political attack and its centralised political structure gives it the ability to withstand a lot more economic pain than most analysts assume it could, should it decide to be confrontational.

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President Xi warned in June that, where Western nations tend to turn the other cheek to confrontation, "we punch back". He could be using hyperbolic language, too – but what if he isn't? Then consider that Trump is ultimately a prisoner of his own support base, and of his demonstrated craving for positive social media feedback from that base. That dynamic may push him to become more extreme than even he wants to be. We could therefore easily find ourselves in an unintended escalation towards a full global trade war affecting up to $500bn of goods. Such a confrontation could be just about endurable given a reasonably robust economy, and all indications seem to point to a robust economy on the other side of the Atlantic. Except for one matter: the yield curve in the US appears to be flattening. True, the 10-year and 30-year Treasuries have not moved, but the 2-year bond is doing the flattening. If the curve inverts, we would have a very strong signal for a recession. So we might end up with a global trade war occurring at the same time as a recession, which, given the experience of the last time that happened in the 1930s, might be a dire outcome indeed. I'm not saying such an outcome of events is inevitable or even probable but merely that markets appear to be discounting even the possibility that it might, which is not good.

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My second worry is that that the bull run is pretty long in the tooth. QE has put us in an unusual position, and appears to have distorted valuations and economic interdependencies. Free money and the continuation of QE has convinced many that we are in a new paradigm, but I am not convinced that the world shifts that easily. To my mind, the bull run is ageing ungracefully, and the market does not seem to want to admit it must end sometime.

Thirdly, after 30 years of not needing to use it, we have as an industry lost our skill in asset allocation, which was a skill in choosing between widely diverging asset classes and currencies in a sometimes desynchronised economic environment while cognisant of major political risks. For three decades asset managers have simply bet either that the economy was growing or not, as the world was pretty much in sync, and we've only had one currency – the dollar – to worry about. Why should this be a source of worry? Today when we use the term "geopolitical risk" we generally refer to minor regional disruptions that might indicate that the price of oil might go up. However, there was a time when it was used to explain how non-economic factors could shape the pathways of the economies, capital markets and currencies of even developed markets. At a cursory glance geopolitical risk in its original sense appears to be making a come-back. Consider the election of the far right in Europe, the Putin effect, China's growing power and even the recent elections in Mexico. I worry the asset management business no longer has the skill-set in house to truly understand the political machinations of various governments and states or how they might interact within the context of a multi speed global economy and work it all out. Closer to home this relates to Brexit. All the analysis I read shows a remarkable lack of concern about the asymmetry of the interdependence of trade between the UK and the EU (which goes a long way to explain the government's white paper). This same lack of appreciation of either the asymmetry of economic dependence between the two blocs or of the probable political effect of protectionist talk from the US on the EU leadership to reinforce the bonds of the union by our own political Brexit elite might yet lead to the collapse of Tory rule.

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Investors are not preparing for the possibility that things could go really wrong. They are confident the signs of the last crisis aren't appearing so are underestimating the risks, thinking it will all turn out fine. Why is all this important? Not so that they may put a "risk off" trade on. That is simply attempting to trade the volatility (just like the in the noughties), but rather because long-term investors should be preparing, because if or when the crunch does happen, it is precisely when they should be buying. After all, despite my worries about the level of markets and the ability of the current generation of asset managers to deal with a complex politico/economic situation that this generation has not experienced before, there are long-term trends that remain very attractive: the march of alternative intelligence, alternative energy and emerging markets demographics. But you must be ready to jump – and the time to prepare is now.

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