Key Questions

Are We Really Safer Today?

by George Mateyo, Chief Investment Officer, Key Private Bank

At the margin, yes. But risks remain and investors should remain vigilant and diversified.

Following the historic summit between North Korean and the US, President Trump declared, "…everyone can now feel much safer." Is this true? What should investors be considering given the major events in the world today?

Most pundits agree the Summit yielded few substantive results. Kim agreed to "complete denuclearization," but no timeline was defined nor details were specified. Still, talks will continue and in contrast to the heated rhetoric over whose button is bigger, it is true that the odds of a conflict have diminished.

Elsewhere, political tensions in Italy have also eased after concerns that Italy might withdraw from the EU. Italy suffers from numerous economic and political challenges, and unlike the past when the European Central Bank intervened, Italy's problems are somewhat self-inflicted, suggesting that the ECB would be more reluctant to intercede.

Risks of an "Italeave" moment are not believed to be imminent and the situation appears to be contained. But it is doubtful that a crisis in Italy would be an isolated incident and it would pose significant risk to an economically important region. That said, most Italians support the euro. Italy and the Eurozone both derive benefits from Italy remaining.

Last week the Federal Reserve raised interest rates for the seventh time. When they began raising rates they were zero, so by historical standards, interest rates are still low. The change in rates, however, is noteworthy and will inevitably slow the economy down. It is a reminder that the ultra-accommodative monetary policy era has ended.

During periods when liquidity is reduced, financial strains become evident. As Warren Buffett said, "When the tide goes out, you learn who's been swimming naked."

This summer we recommend investors take the following measures:

1. Ensure your portfolio is diversified. Earlier this year, we gradually reduced our recommended exposure to equities and emphasized a further underweight to fixed income. With these proceeds, we recommended strategies designed to profit from exposures beyond traditional investments.

2. Recommit to actively managed strategies. After years of headwinds, we believe the environment today is ripe for managers to identify opportunities and navigate away from trouble. Pure beta strategies might not be so fortunate.

3. Properly calibrate your liquidity needs and maintain 6-12 months in cash. We are not bearish on the economy. In fact, we believe the US economy is likely able to withstand the negative impact caused by tariffs. Tax reform is providing a catalyst to investment spending which is providing a boost to the economy.

That said, the stock market is not the economy, and as we continue to believe volatility will persist, maintaining liquidity provides optionality and security, two important elements in a world that may not be entirely safe.

For questions, please contact your Key Private Bank Portfolio Manager.

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