FINANCIAL REVIEW

Markets

Magellan's Hamish Douglass says tread cautiously in unpredictable markets

Sarah Turner *Reporter*

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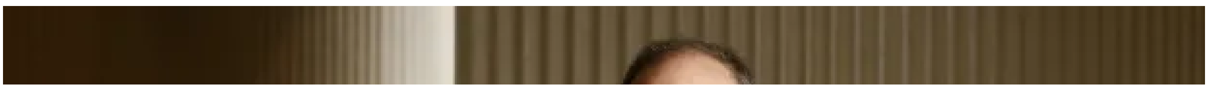
Magellan chairman and chief investment officer Hamish Douglass is treading cautiously in markets that he regards as stuffed full of two-way risk, saying, "I'll reverse Chuck Prince from 2007, the music might be playing but it's not time to dance."

Mr Douglass was invoking the famous line by the then-chief executive of Citigroup from July 2007, just before the full force of the global financial crisis hit.

"When the music stops, in terms of liquidity, things will be complicated," Mr Prince told the *Financial Times*. "But as long as the music is playing, you've got to get up and dance."



Magellan chairman and chief investment officer Hamish Douglass is treading cautiously in markets that he regards as stuffed full of two-way risk. **Daniel Munoz**

Uncertainty not conviction rules

For Mr Douglass, the best way to cope with current markets is to avoid taking high conviction views, the fund manager told the Portfolio Construction Forum markets summit 2019 in Sydney.

"Do not, in this environment, take a strong conviction on these issues," he said. "No one knows what's going to happen next."

Some of the big issues that investors are grappling with include the possibility of recession, of a crisis in Europe, questions over China and the ongoing effect of quantitative easing, the fund manager noted.

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But opinion varies wildly on the potential implications of these issues for markets. Mr Douglass noted a very broad range of investor views which he said can be "entirely plausible" but at times "completely different".

And there is no point in looking back to history for clues as to how to invest in today's markets, he added.

"I think that the environment we are in at the moment, it is very unpredictable," he said. "There are very few analogies in history that will give you a guide."

The fund manager pointed to the relationship between wage growth and unemployment, which is commonly measured by the Phillips Curve and appears to have broken down since the global financial crisis.

"Why isn't the Phillips curve working? The Fed has no idea," he said. With sufficient wage inflation, all things being equal, the Fed would be behaving more hawkishly.

But the Fed is arguably adding to the environment of uncertainty, with US monetary policy dramatically changing course since December from a tightening bias to data dependent.

The Fed is spooked

Federal Reserve chairman Jerome Powell was "spooked by Davos, spooked by Trump and spooked by December markets and [then he] completely flips and puts the punchbowl out again on the basis that we are probably not going to see inflation," Mr Douglass said.

The high-performing fund manager has been on alert for an outbreak of inflation in the US economy, which would necessitate rate rises.

"I would be very cautious about this because we don't know if there's going to be an inflection point until there is an inflection point. Certainly there's been more slack in the economy," he said, questioning the relationship between productivity growth, technology and wages.

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"Clearly, the labour market hasn't responded to the unemployment rate coming down, clearly we have seen participation rates going up, and there was a lot of excess capacity in the system globally here.

"Whether it's been offset also by some of the productively issues, no one seems to be able to measure [that] at the moment," he said.

"All I can say is that at some point you hit an inflection point where something tightens up enough and you start to get inflation that no one can see at the moment. If that happens, all I can tell you is hold onto your seats," Mr Douglass said. "It's perplexing central bankers around the world and people are now giving theories about why it's not happening. I just wouldn't get over-confident that those theories will hold. At some point you would expect it to break."

The economic cycle is another area where the signals aren't clear, he said. "I personally think that we are very late cycle here, but whether we are late cycle meaning we are two years away, or six months away, again, there are very plausible arguments."

Mr Douglass was one of the best-performing Australian long-only managers for 2018, returning 9.8 per cent for his Magellan Global Fund and proving Magellan's expertise in capital protection. The 9.8 per cent return was achieved against an index return of 1.4 per cent (expressed in Australian dollars).

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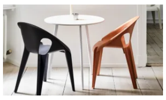

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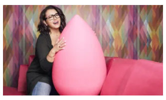

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