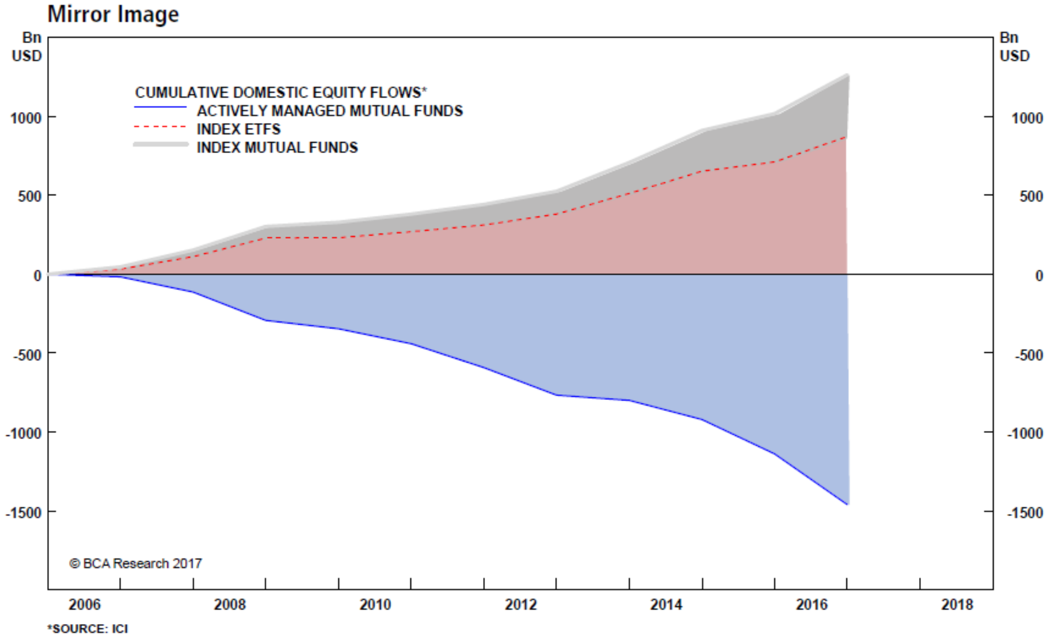
**A Bubble In Complacency:**

The investment world loves a bubble. In recent times we've had bond bubbles, equity bubbles, property bubbles, technology bubbles….a bit like supporters of a certain East End football club, we're forever blowing them. So has a new one inflated?

We hear a lot about the growth of passive funds over active. Some have gone so far as to call it a passive "bubble", citing the endless flow of new money going into index funds as a risk to distorting asset prices and stretching valuations beyond limits so that the bursting of the bubble becomes inevitable. What the table below shows, however, is that there is not so much "new" money flowing into these vehicles as is imagined. In fact, there is almost an exact mirror image of the funds flowing **into** passives to that of funds flowing **out** of actives. One type of fund is simply replacing the other as the vehicle of choice for people with money to invest. The growth in valuations, it can be argued, is therefore justified because the valuations reflect the state of the global economies rather than pure weight of money hitting equity markets. After all, in a successful capitalist world, one should ***expect*** the price of shares to keep hitting new highs.




What this does suggest though, is that a **bubble in complacency** may have built up. The pattern above shows that there has been a massive shift from investors who want to ***choose*** what they invest in towards making an active decision to ***invest in everything***. Because that is what a passive fund is….a cheap vehicle to invest in everything within the index that it is replicating, whereas an active fund selectively invests in assets within its parameters. Of course, the rise of passives has been on the back of many active managers charging too much for offering what is largely an index fund with a bit of tinkering around the edges, but that discussion is for another time.

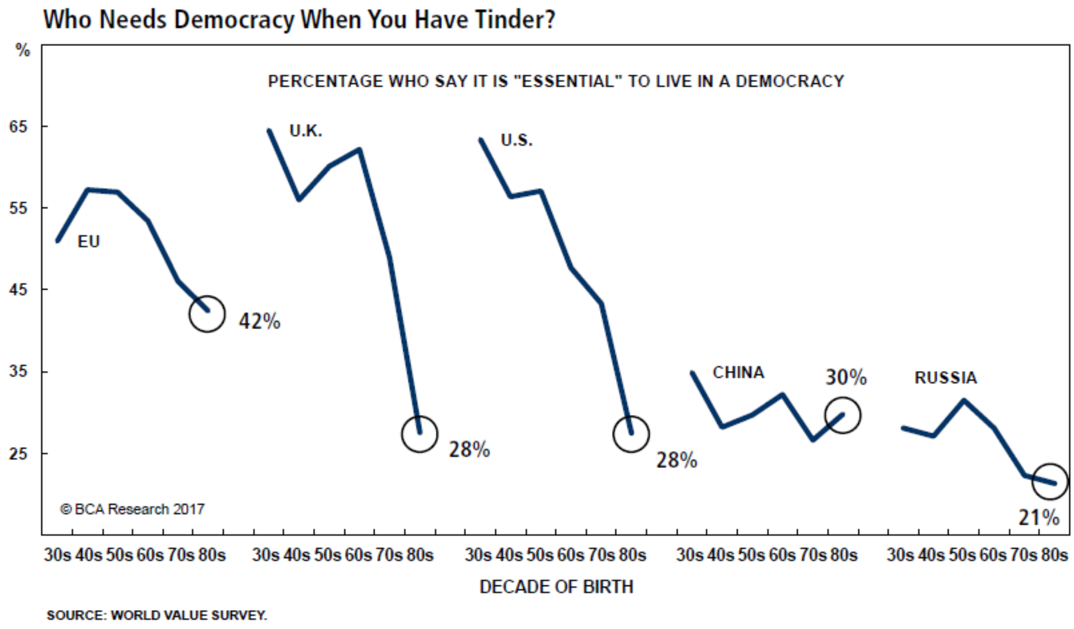
To be clear, we are style-agnostic. We don't much care whether we invest in an active or a passive fund, just so long as it offers our investors a fair return for a fair price. However, the rise in complacency worries us a lot because the growth in passives today is so reminiscent of the growth in passives witnessed at the end of the last great bull market in the 1990s that ended spectacularly in the early Spring of 2000. When markets do nothing but go up, why not invest in everything? About a third of all companies in the Russell 2000 Index don't make any money, but the trajectory of those that do make up for the minorities' failings. Does it make sense to invest in failing companies? Not really, but momentum can mask the negatives.

And if you can invest in everything cheaply, so much the better. But what happens when the direction changes and valuations come down and stay down for a prolonged period as in 2000-2003? We would argue that you would be very keen to choose what you invested in rather than just sitting in a destroyer of value.

With a real life Game of Thrones going on at the moment (changes due in the Central Banks of the US, Peoples Bank of China, Bank of Japan, ECB as well as newly strengthened regimes in China and Japan) the risk of a policy error is somewhat elevated. Leaving this risk aside, economies around the world appear to be in rude health and a further step forward in markets can be easily imagined as we approach and progress into 2018. But when this ends – sadly we don't know when this will be, but it will – we forecast that there will be a major reversal of the trend portrayed by the chart above and those active managers that remain will be major beneficiaries of the recycled capital from the "buy everything" brigade. Until that time arrives though, let the complacency reign.

**Who Needs Democracy?:**

This chart caught our eye:



There is absolutely no doubt that attitudes, and how one expresses them, are changing around the world, demonstrated by the steep decline amongst younger elements of society ranging from the UK, EU, US and Russia that democracy is not an “essential” any more (interestingly not a trend reflected in China). This could have profound, longer term implications, but it got us thinking about how social media has changed attitudes too. We’ve probably seen the effects of this already through the Brexit and the Trump results. It is the norm now, it seems, for self-selecting like-minded groups to cluster together on the internet, reinforcing their own beliefs within their groups to the exclusion of listening, or considering, voices and opinions from other such groups that differ from their own.

Hence the astonishment and refusal to accept the result of the votes that led to Brexit negotiations and the Trump administration amongst many of these type of groups. Democracy is not working in the eyes of an extremely sizeable minority because it didn’t agree with their own majority view.

We heard recently that 45% of Americans receive their news through Facebook. So what happens if the likes of Facebook, Twitter and Google, the very facilitators of this state of affairs, don’t like what they are allowing to be shared? It doesn’t take a huge leap of faith to imagine some element of control being filtered in. It’s not beyond the realms of fantasy to see President Trump’s next election not being fought against the Democrats per se, but against a Democratically-leaning social media network of networks. After all, democracy isn’t essential any longer to many of their users.

Of course, if they are pre-emptively regulated, their current share prices look a bit rich, to say the least.

These are our views, as always, and don’t constitute advice in any way.



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