Weekly Digest
14 May 2018
The weekly insight into world stock markets

Going Nowhere Fast

At a conference last week I started my presentation, as I often do, by providing a scorecard of our achievements for the year so far. It's important to be accountable for one's views, not least, perhaps, because one can learn as much, if not more, from the mistakes as from the successes. It was gratifying to be able to show the audience more ticks than crosses, and I even awarded myself a double tick for two of the predictions we made at the start of the year. One was that there would be a 10% correction for equity markets, the other that "Trump continues to provide geopolitical challenges". (Some might argue that the latter was the equivalent of taking a penalty at an open goal, but they evidently don't remember Diana Ross's "epic fail" during the opening ceremony of the 1994 World Cup.)

Unfortunately, fine words butter few parsnips, and even getting most of the strategic calls right has failed to provide much in the way of investment returns so far this year. The FTSE UK Private Investor Balanced Index shows a total return of just 0.7% year-to-date. Indeed, it only crept back into positive territory last Thursday, having been sporting a loss of more than 5% late in March. Performance from the start of the calendar year is certainly not helped by the fact that last year was such a good one. Rolling 12-month performance looks a lot better, with an 11% gain. Investing is very much a marathon rather than a sprint.

At the regional equity level, I have rarely seen such a small amount of performance divergence when measured in constant currencies. World equities are up 2.0% YTD. The UK is +2.2%; USA is +2.3%; Europe (ex-UK) is +1.8%; Japan is +2.6%. Any relative outperformance would quickly be eaten up by dealing costs if we tried to chase every last basis point available. Asian Emerging Markets are the laggards (+0.6%), but within that China is +4.5%. (All data are FTSE Indices from Bloomberg, apart from US, which is S&P 500.) Bond markets have provided small negative returns so far, and it was notable that when equity markets sold of aggressively in February bond markets failed to provide balancing positive returns, which very much defied the correlation pattern that has prevailed since the early 1990s.

The outstanding outlier in terms of performance this year has been the oil price, which is up about 15%. We don't invest directly in commodities, but we are able to invest in oil producers. The two UK-listed majors, BP and Royal Dutch Shell, have been strong beneficiaries of the oil price rise, both showing double-digit gains for the year. Their high combined weighting in the FTSE 100 Index (16.6%) means that they have a big influence on the ebbs and flows of what is generally quoted as being "the market". So far this year they have contributed 123 positive index points – which is a lot more than the total net gain of just 32 points. The rising oil price is good for the index, but not necessarily as good for the economy, as it reduces consumers' buying power for other goods and services. One also needs to consider why the oil price is going up. Some of it is down to higher demand, which might be a decent indicator of stronger economic activity, but constrained supply (both actual and potential) appears more to blame. The oil majors, burnt by their experiences in the last cycle, have been slow to commit to the expenditure required for new production (which at least has the benefit of improving short-term cash flows, which, in turn, underpins the attractive dividend yields); more recently we have seen increased tension in the Middle East, not least with President Trump withdrawing from the nuclear deal with Iran. Given that we have already witnessed some deceleration in global economic growth in the first quarter, further sharp rises in the oil price would not be particularly welcome.

The good news is that the corporate sector, in aggregate, continues to prosper. Boosted by tax cuts (and that strong oil price), US companies are forecast to grow earnings by more than 20% in 2018, about the twice the rate of growth expected in the UK and Europe. However, this could well be "as good as it gets". Indeed, the CEO of the US construction equipment maker Caterpillar made just such a comment on the results call a couple of weeks ago, describing the excellent first quarter as a "high water mark". Cue an immediate 6% fall in the share price despite an upgrade to current year guidance. Investors need tastier carrots to lure them forward.

Of course, one can paint a different picture by changing the reference date. The FTSE 100 Index has just completed a seventh consecutive week of gains from its March low (something not achieved since 2005), rising 12% in the process and threatening its all-time high of January this year. In the mea culpa department, we have remained underweight during this period in our tactical asset allocation, although we did note in February that there was a growing feeling of "last to leave the UK market, please turn out the lights", so we certainly weren't urging anyone to bail out then. The relative performance looks less impressive when one takes into account the fall in the pound over the same period (notably -4.5% vs the US dollar).

As we enter the traditionally less productive period for investor returns that starts in May and runs until September, we remain in no hurry to commit portfolios more aggressively to equities at this moment.

Finally, Imelda Marcos, former First Lady of The Philippines was noted for her extensive collection of shoes. This week, Hole In My Shoe was a 1967 hit for which band?

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

ITV	13.7%
Royal Bank of Scotland Group	8.0%
Next	7.7%
Glencore	7.3%
Ashtead Group	6.9%
BHP Billiton	6.9%
Evraz	6.4%

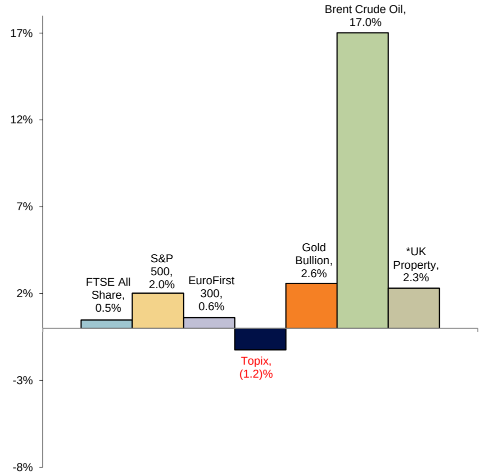
Source: FactSet

FTSE 100 Weekly Losers

BT Group	-7.6%
Centrica	-4.8%
Burberry Group	-3.7%
Compass Group	-3.3%
Randgold Resources	-2.6%
Admiral Group	-2.5%
Severn Trent	-1.4%

Source: FactSet

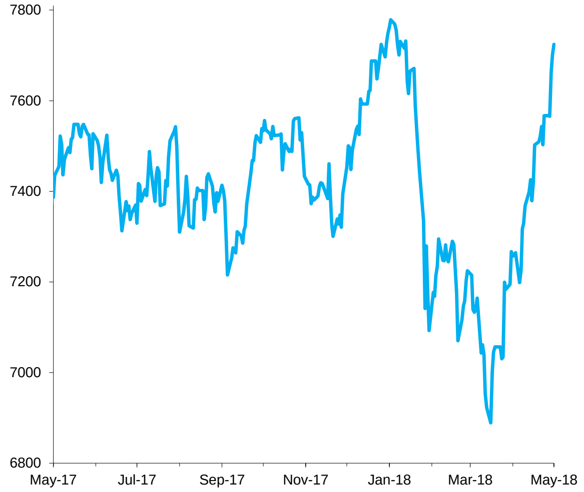
Year to Date Market Performance



*Lagged to latest UK IPD Total Return All Property Index (Mar 2018)

Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet

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