Weekly Digest

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The weekly insight into world stock markets

Into The Unknown

The turn of the calendar to the second half of the year always presents an opportunity to reflect on what happened in the first half, but today is more notable for taking us into uncharted territory. No US economic cycle has ever lasted longer than the current one, at least while such data has been collected since the 1850s. This one now breaks the ten year barrier. No doubt that will give a certain president ample opportunity to claim credit for such longevity, but it also gives more cautious commentators and investors the chance to remind us that the end must be nigh. We have long stuck to the view that economic cycles do not die of old age. The usual catalyst is excessively tight monetary policy, and in the past this has often been due to central banks deliberately trying to squeeze inflation out of the system. Right now there is little need for that course of action. Indeed, if anything, there is not enough inflation in the system, and we have most recently seen both the US Federal Reserve and the European Central Bank pivoting towards more dovish policy.

We believe that it is currently politicians rather than central bankers who are most likely to upset the apple cart. President Trump remains to the fore of pretty much every potential risk, with trade wars and his increasingly belligerent stance towards Iran representing the greatest threats. This morning markets are celebrating the weekend news that US/China trade talks are back on, and our opinion continues to be that neither side benefits from tariff escalation. Trump wants a strong economy and stock market to bolster his 2020 election campaign, even if being tough on China is now a pre-requisite policy for anyone with White House aspirations. For its part, China needs to deliver growing prosperity to its population to maintain social cohesion and thus the primacy of the Communist Party.

The trouble with headline statistics is that they often fail to give the whole story. The record US economic expansion is a case in point. The longest it might be, but it has also been one of the shallowest. Thus despite its length it has not featured the same build-up of excesses we have witnessed in previous cycles, especially in the household sector. In fact, US households have spent much of the last decade rebuilding their finances. However, it has been noted that economic cycles have been notably longer since developed countries abandoned the gold standard in the 1970s. The financialisation of economies – for which read the creation of burgeoning amounts of debt to support consumption as well as the massive increase in the size of financial markets relative to the economy – has not only increased growth but also meant that policymakers have had to pay far greater heed to share and bond markets: thus the birth of the Greenspan, Bernanke, Yellen and now Powell “puts”, by which monetary policy is loosened in response to weaker markets. The debate rages as to whether this course of action will inevitably lead to a huge end-of-cycle melt down or whether central banks, possibly aided and abetted by politicians, can keep the plates spinning for years to come. We see insufficient evidence to bet strongly in either direction currently although do acknowledge that markets have the potential to be more volatile while the arguments swing back and forth.

Turning back to the first half of the year, it has been a very pleasant one for investors, despite a trade war-related setback during May. We argued at the start of the year that growth and valuation concerns had been over-discounted in asset prices during the fourth quarter of last year, and embarked on our annual Vision tour with what, to many, was a surprisingly upbeat message. To be honest, I would say that things have gone even better than we expected. One feature has been the fact that pretty much all asset classes have advanced together, which has elicited some head-scratching. After all, one might not expect safe-haven assets such as government bonds to be delivering decent returns from such a low yield base at the same time as equities have been so strong. Even gold, something of an insurance policy against more extremely negative outcomes, rose around 10%. Again the headline indices fail to tell the whole story. Not for the first time in recent years, investors have been gravitating towards sectors and stocks where they identify more persistent long-term growth trends and defensible profits. Thus Technology has again topped the charts in the US.

In the UK, three of the top four performing shares in the FTSE 100 during the first half were Spirax Sarco, Halma and Ocado. The former two are both classic “long duration” stocks with successful track records and high returns on capital. Ocado is at the forefront of providing logistics solutions to the Food Retail industry. Even so, being relatively small companies, they only contributed a cumulative twenty-six of the six hundred and ninety-seven points advance made by the index. The big points winners, by virtue of their size and a rally in the underlying commodity price, were the oil companies Royal Dutch Shell (+14%, +106 points) and BP (+14%, +53 points). Resource companies Rio Tinto (+41%, +65 points) and BHP Group (+31%, +40 points) also featured highly thanks to a very strong iron ore price, itself the beneficiary of multiple supply disruptions. But it’s also notable that two more “long duration” or “bond proxy” shares made it into the top six points scorers, namely Diageo (+22%, +59 points) and Unilever (+21%, +37 points). The good news is that Spirax, Halma, Diageo and Unilever all feature in our list of preferred shares. The bad news, though, is that their valuations now leave little cushion for even a modicum of disappointment.

John Wyn–Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

EasyJet	7.9%
John Wood Group	6.7%
TUI	6.0%
3i group	4.8%
Johnson Matthey	4.6%
Berkeley Group Holdings	4.6%
Evraz	4.6%

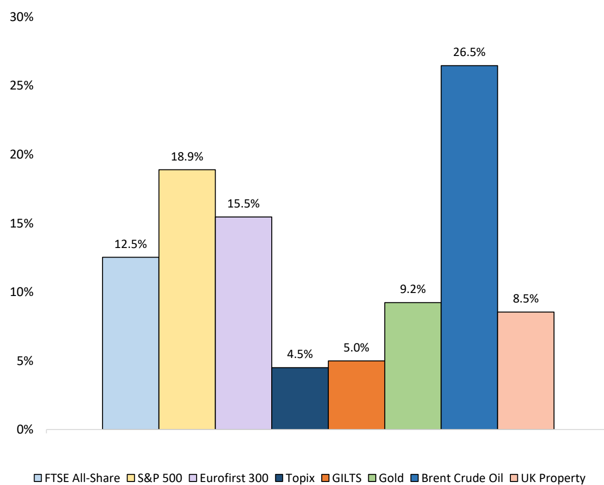
Source: FactSet

FTSE 100 Weekly Losers

Rightmove	-6.0%
Rolls-Royce Holdings	-4.7%
Tesco	-4.2%
Lloyds Banking Group	-2.6%
Glencore	-2.5%
BT Group	-2.4%
United Utilities Group	-2.3%

Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months

Source: FactSet

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