Weekly Digest
2 September 2019
The weekly insight into world stock markets

Investec
Wealth & Investment

Little Ado About Quite A Lot

Market reviews covering the month of August highlight that it was a weak period for equities, but all the damage was done in the first few days. The indices have been choppy since, and are struggling to find direction. Bond markets have been more decisive, with yields heading inexorably lower. Gold has been the standout gainer, rising 8%. Reading through the updated views of a number of sell-side strategists on my return from holiday, I found no evidence of any major shift in opinion. The more bullish ones were relatively relaxed and even encouraged by the offer of shares at lower prices; the bears were vindicated by the falls and only more entrenched in their views that a deeper correction (or fully-fledged bear market) is looming. This impasse is reflected in relatively low trading volumes. The VIX Index of volatility, which spiked up to 25 during the setback, is currently around 17, which is elevated relative to recent history, but still below its lifetime average of around 20.

The single largest driver of sentiment at a global level remains Donald Trump's Twitter account. The fall in markets at the beginning of August was the result of his announcement that tariffs would be imposed on the balance of around $300 billion of imports from China that were not already affected. He subsequently softened the impact by exempting some key electronic goods on the basis that he didn't want to spoil Christmas (!), and we have had a constant ebb and flow of news ever since from both sides. The pattern seems to be to start with a shocking headline which is then followed by concessions that make him appear reasonable followed by optimism that a mutually beneficial deal can be reached. The key factor is that if equity markets are getting too twitchy the President sends a supportive message.

Evidence is mounting that the threat to global trade is having a negative effect on economic growth, notably through the investment channel. Companies are reining in capital investment, particularly Foreign Direct Investment. US GDP growth has settled back to around 2%, Germany's turned negative in the second quarter, and China's is the slowest since the early 1990s. That leaves global corporate earnings growth barely in positive territory for the year. The threat of further deceleration is what is weighing on equities. The counter-weight to that is monetary policy. The Federal Reserve cut rates by a quarter of a percent on the last day of July (for the first time since 2008), and is expected to do so again at this month's meeting. But the message from the bond market is that this is not aggressive enough. The current target rate for Fed Funds is 2-2.25%, but the 10-year bond yield is 1.5%, suggesting at least another 75 basis points of cuts ahead. The expectation of lower rates lessens the probability of the US economy falling into recession, and the lower discount rate supports equity valuations. Even so, headline indices fail to capture the divergence in performance between "Growth" stocks, which continue to perform well, and "Value" stocks, which are struggling.

The shift lower in bond yields has taken investors into truly unknown territory. Germany's government has now issued 30-year Bunds with a negative yield to maturity, and some $17 trillion worth of global bonds also have a negative yield. Some of this is down to central bank purchases, and some down to regulation-driven buying by financial institutions, but there is little doubt that there is a large weight of money backing an increasingly negative economic future. With yields as low as they are, all the return is now dependent upon capital gain, with equities seen as the best source of income. Quite a turnaround from the situation that prevailed for most of my life in the City.

In the UK Ben Stokes is about the only person who can keep Brexit off the front pages, and it does feel as though we are approaching some sort of defining moments. The arguments over the alleged assault on our (unwritten) constitution implicit in Boris Johnson's plan to prorogue Parliament for an extended period are for judges to settle, but his actions have opened up yet another rift in an already deeply divided country. More uncertainty lies ahead, with the odds of a general election having shortened considerably. From a portfolio management perspective we are happy to have maintained an underweight sterling exposure (both via cash and bond holdings as well as in our equity selection).

It is notable that overseas corporate buyers are beginning to see value appearing in the UK. Entertainment One (owner of Peppa Pig) succumbed to a bid from American toy giant Hasbro, and the pub company Greene King has attracted the interest of Hong Kong's wealthiest businessman, Li Ka-Shing (who has form in buying UK-based asset-backed companies with strong underlying cash flow). Already this year Cobham (aerospace, with 90% of the global in-flight refueling market), Inmarsat (communication satellites) and Merlin (operator of attractions such as Legoland and Madame Tussaud's) have fallen prey to overseas bidders.

I don't write about gold very often, but we do have a line in our Asset Allocation process for it (we suggest that those who can't stomach it hold US Inflation-Protected Treasuries instead, as the correlation between the two is strong). The gold price has risen 19% this year (the i-Shares TIPS ETF has returned 8%), and is now at its highest since early 2013. Yes, it benefits from lower US bond yields (because of the lower opportunity cost of holding an asset that pays no income), but the last time the US 10-year yield was close to 1.5% in 2016, gold was $150 (~10%) lower than it is now, so there is something more going on – increased global geopolitical concerns, and, perhaps, the threat of the outright monetisation of government debts in the event of more fiscal stimulus.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

NMC Health	16.0%
Melrose Industries	9.2%
Fresnilo	8.2%
Ocado Group	8.0%
Antofagasta	6.7%
Anglo American	6.5%
Centrica	6.3%

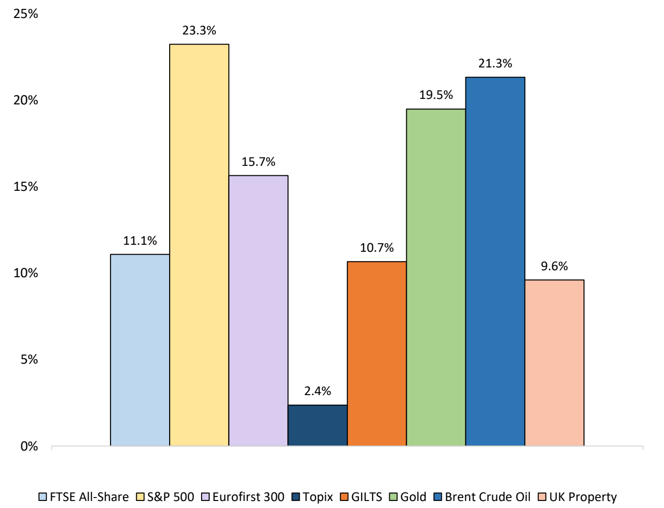
Source:FactSet

FTSE 100 Weekly Losers

Micro Focus	-29.3%
John Wood Group	-3.7%
British American Tobacco	-2.7%
Aviva	-2.0%
St James's Place	-1.6%
Direct Line Insurance	-1.6%
RSA Insurance Group	-1.4%

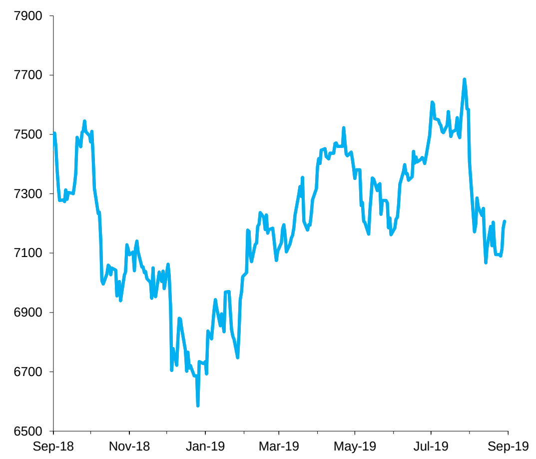
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet