Investec Wealth & Investment

Arrivederci…. Bonjour

Last week saw Mario Draghi (an Italian) sign off from his role as President of the European Central Bank (ECB). He is replaced by Christine Lagarde (who is French), who until recently was the Managing Director of the International Monetary Fund (IMF). This change is potentially significant. Unlike any of her predecessors in the role, Mme Lagarde is not an economist. Her career started in law. Subsequently, she had various roles in the French government, culminating in running the Finance Ministry during the financial crisis. She joined the IMF in 2011, just in time to help sort out the Greek crisis. She is no stranger to stressful financial situations, and one can only hope that she won't need to call on her experience soon.

One of her key strengths is reported to be consensus-building, and this could be very useful as she enters a somewhat fractured ECB. Several central bank leaders from northern member countries have openly criticised the latest round of monetary easing. They complain that it is hampering the banking system and disadvantaging savers, while it also provides an effective free ride to southern countries that they deem to have been profligate in the past and who have not undertaken sufficient restructuring of their banks. A "one size fits all" interest rate policy has been problematic in the past, helping to fuel the boom (and subsequent bust) that ran through the financial crisis and the subsequent euro zone crisis. It doesn't appear to be universally supported now either.
Part of the problem is that it is the only real tool available to the ECB, alongside Quantitative Easing. As long as there is no fiscal and/or banking union within the euro zone, it is very much "every man for himself". It is generally agreed that the French President, Emmanuel Macron, played a canny hand by manoeuvring Mme Lagarde into the role. He is very much to the fore in attempting to create more unity in Europe in terms of financing and even fiscal transfers. It will be interesting to see how this develops.

Mme Lagarde herself has also been vocal in exhorting governments to do more to help stimulate growth, and governments (or more precisely aspiring governments in the main) are listening. Austerity is becoming a dirty word. The limitations of monetary policy are becoming clear. Banks are struggling to make decent returns in a world of low or negative interest rates, and there are fewer incentives for those looking to commit capital. The "next big thing" could be fiscal stimulus, possibly underwritten by central bank purchases of government bonds.
Even so, this is not necessarily a "silver bullet" solution. A lot depends on the efficacy of the spending, and there is some concern that it could be altogether too successful when it comes to reigniting inflation. Then there is the question of central banks buying the debt; could this represent an actual or de facto monetisation of the debt, debasing the value of the existing stock of money? It is no surprise to me that the best performing asset class over the last twelve months has been Gold, an asset which attracts a lot of vitriol, but which has a history of maintaining its real value, especially when governments are profligate. One thing is for sure: the monetary experiment of the last decade, while providing fantastic returns for "capital", has done little for "labour". Those aspiring governments could well be elected on a platform of redressing the balance.

And talking of aspiring governments, we have at least three in the UK looking forward to a general election on 12th December. Parliament will sit for the last time tomorrow, something that Guy Fawkes failed to make happen. An old joke has it that he was the last person to enter the Houses of Parliament with honest intentions! The potential for tactical voting combined with the peculiarities of the first-past-the-post electoral system make this an especially difficult election to read. What is clear is that the usual manifesto promises will play second and third fiddles to Brexit.

And on the Brexit front, the key development is that a "No Deal" departure appears to be off the table for now, at least. I say "for now" because there remains the risk that it could happen at the end of the transition period if no trade agreement with the EU has been reached. Retreat from the cliff edge has put some pep back into the shares of companies with a greater focus on the UK economy. Since this all started to become clear on 9th October, there have been strong double-digit gains for the likes of Barclays (+16%), BT (+15.5%), Taylor Wimpey (+15%), Legal & General (+14%), Standard Life Aberdeen (+14%) and ITV (+14%) , to name but a few. It is quite probable that much of the trading activity has been confined to "Brexit baskets", groups of stocks that have been gathered into tradeable portfolios by investment banks, with a concentration on larger, liquid names.

Following a long period of aversion to UK-focused names, we can now see an argument for portfolio managers to increase their exposure, especially to Mid-Caps, which have lost their traditional valuation premium versus Large Caps. This could be underpinned by some of the afore-mentioned fiscal stimulus being applied here in the UK. All the major parties are on message. Indeed, had the Conservative government not succumbed to an election, Sajid Javid's first Budget as Chancellor would have been more generous than any in recent history, busting all current budgetary constraints and fiscal rules.

Jeremy Corbyn and Jo Swinson have similar plans, although with a greater degree of "soak the rich" philosophy attached. Although a Labour government would present a real threat to wealth, we continue to calculate that a Labour majority is highly improbable. Even a Labour minority-led coalition would have its guns spiked by its coalition partners. Therefore we see minimal risk on that front presently.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Fresnillo	5.7%
Flutter Entertainment	5.5%
Ashtead Group	4.9%
EasyJet	4.9%
IAG	4.2%
Intertek Group	4.2%
BAE Systems	4.0%

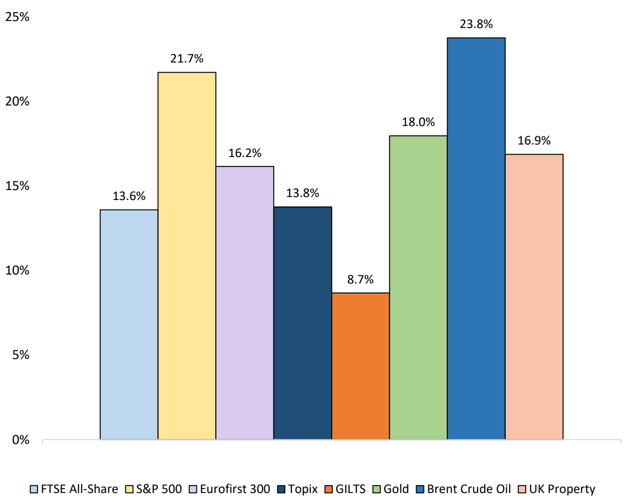
Source:FactSet

FTSE 100 Weekly Losers

NMC Health	-9.9%
Imperial Brands	-6.7%
RBS	-4.9%
HSBC	-4.6%
Lloyds BG	-4.5%
Sainsbury	-3.6%
Direct Line Insurance	-3.5%

Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months

Source: FactSet