Weekly Digest

8 January 2019

The weekly insight into world stock markets

Investec
Wealth & Investment

Back to Business

Happy New Year! It feels as if a lot of water has flowed under the bridge since my last Weekly Digest which was only three weeks ago. At the time I noted the poor performance of equities and risk assets in general during 2018, but by Christmas Eve markets had taken another lurch down, with the S&P 500 Index in the US doubling its losses for the year before recovering into the New Year. Those of us who were dedicated sad enough to check the financial news on Christmas Day were greeted with a 5% overnight fall for Japan's Nikkei Index – the market equivalent of the lump of coal that was traditionally given to naughty children at Christmas.

There seems little doubt that market liquidity was very thin over the holiday period, which means that we should take some of these more exaggerated movements with a pinch of salt because a relatively small amount of selling can have a disproportionately large effect on prices. Not only were a lot of traders away from their desks, but investment banks also tend to reduce their exposures ahead of the year-end to window dress their balance sheets. However, the swings are indicative of a nervous mindset amongst investors, and not entirely without reason. We have written for some time now about the gradual winding down of post-financial crisis emergency monetary policy settings. Not only are interest rates creeping up here and there, most aggressively in the US, but also, now that the European Central Bank has ended its programme of Quantitative Easing, the aggregate balance sheet of developed economy central banks is shrinking. This is weakening the liquidity tailwind that has been so beneficial to financial assets for most of the last decade. Indeed, it potentially creates a headwind.

The US Federal Reserve raised interest rates for the ninth time in this cycle on 18th December (to a still not very high range of 2.25-2.5%), but markets viewed the commitment to carry on raising rates in 2019 as a policy mistake in the making, and that is what precipitated the sell-off. (It was exacerbated, almost comically were it not so serious, by a statement from US Treasury Secretary Steve Mnuchin that he had met with bank chiefs and that there was nothing to worry about. This was taken as a signal that he knew there really was something to worry about!) There has since been a major re-appraisal of the outlook for US interest rates, not least from the Fed chairman himself. Futures markets now suggest that the next move is more likely to be a cut than a rise, and Jerome Powell, in a speech on Friday, said that he would contemplate pausing the policy tightening if warranted. The fact that he was sharing a podium with his two immediate predecessors, Ben Bernanke and Janet Yellen, was poignant. What was initially dubbed the "Greenspan Put", when Fed chairman Alan Greenspan cut interest rates in 1987 in the face of a stock market crash, evolved into both the Bernanke Put and the Yellen Put. Critics claim that this phenomenon has distorted financial markets by reducing downside risk, creating various bubbles in the process, encouraged the misallocation of capital and contributed to the increase in social inequality. In the short term investors may applaud the potential birth of the Powell Put, but there will be questions about the longer term consequences.

Interest rates are not the only thing exercising investors. The other big global issue is trade, with the US/China axis being the most important. Markets have most recently reacted positively to news of further talks between the world's two largest economies, but the clock is ticking down to the March 2nd expiry of the extension that Donald Trump gave to China at the Buenos Aires summit meeting to comply with various demands. Some sort of agreement would be taken well, but if the US's strategy is as much about keeping China in its place as it is about levelling the playing field for trade, then relief could be short-lived. I am probably feeling slightly more pessimistic having finally caught up over the break with the Channel 4 documentary about Donald Trump which is now available on Netflix. It paints a picture of a man who is willing to take high risks, cut corners and throw any number of friends and foes alike under the bus to fulfil his ambitions and to hell with the consequences. Maybe bearable if it's just his own empire at risk – but the global economy?!

More positively, from a contrarian standpoint, markets have already gone a long way towards discounting at least a sharp slowdown, if not a full blown recession (something that we still don't see on the cards). Sentiment is also poor. A BlackRock survey of institutional clients published over the weekend reports that 51% are looking to reduce their exposure to equities. Is it a bit late now? If anything we are more inclined to be bargain-hunting than reducing risk. Merrill Lynch's Bull & Bear Indicator has also fallen into "extreme bear" territory, creating the first tactical buy signal since June 2016 (although not guaranteeing that we have seen the lows).

I'm going to leave the vexed question of Brexit for another week, as no progress has been made and the parliamentary vote is just eight days away. Interestingly, in the "Save the Dates" section of its 2019 outlook, the same BlackRock lists March 29th (Brexit Day) as one of only two dates that matter in the UK this year. The other is the start of the Cricket World Cup on May 30th! If only the single thing I had to worry about this year was Joe Root's batting average…

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Next	10.6%
John Wood	6.5%
Ocado	6.4%
Smurfit Kappa	5.3%
Schroders	5.2%
Mondi	4.9%
Rightmove	4.9%

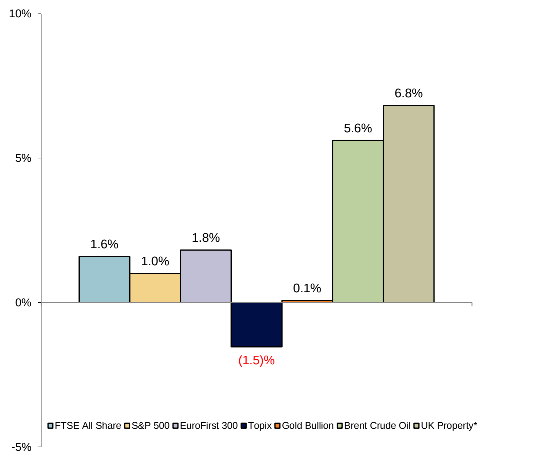
Source: FactSet

FTSE 100 Weekly Losers

IAG	-4.3%
NMC Health	-3.2%
Evraz	-3.2%
Glencore	-2.0%
Sage	-1.9%
J Sainsbury	-1.8%
Informa	-1.7%

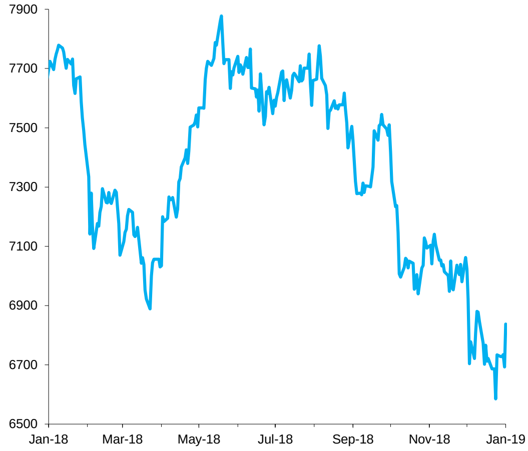
Source: FactSet

Year to Date Market Performance



Source: FactSet
*IPD Total Return to October 2018

FTSE 100 Index, Past 12 Months



Source: FactSet

The information in this document is for private circulation and is believed to be correct but cannot be guaranteed. Opinions, interpretations and conclusions represent our judgement as of this date and are subject to change. The Company and its related Companies, directors, employees and clients may have position or engage in transactions in any of the securities mentioned. Past performance is not necessarily a guide to future performance. The value of shares, and the income derived from them, may fall as well as rise. The information contained in this publication does not constitute a personal recommendation and the investment or investment services referred to may not be suitable for all investors; therefore we strongly recommend you consult your Professional Adviser before taking any action. All references to taxation are based on current levels and practices which may be subject to change. The value of any tax benefits will be dependent on individual circumstances.

investecwin.co.uk
Member firm of the London Stock Exchange. Authorised and regulated by the Financial Conduct Authority.
Investec Wealth & Investment Limited is registered in England.
Registered No. 2122340. Registered Office: 30 Gresham Street, London EC2V 7QN.

IWI740 v1