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OUT OF THE ORDINARY

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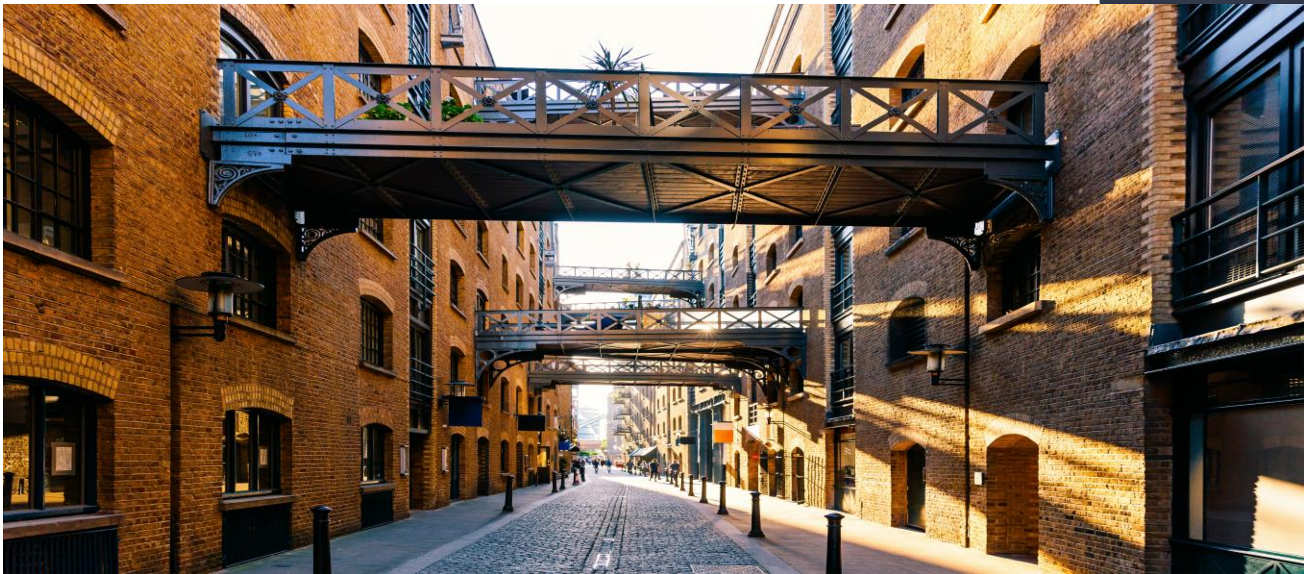
Snakes And Ladders



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Market commentators are always looking for metaphors or analogies to help describe current market conditions, and one of today's favourites is that we are experiencing a "rollercoaster" ride. Indeed, there have been many ups and downs already this year, and probably a few green faces. But the one that keeps coming up for me is "snakes and ladders", the infuriating board game that was a staple of my childhood.

I don't know if children today are being shielded from the nastier possibilities in life, but a quick search of the boards currently for sale suggests that this might be the case. The snakes often have big googly eyes and a relatively friendly demeanour with a limited length to their tails. The ones on my board looked downright evil, and the longest and most devilish one took you from square ninety-eight back to three. Brutal. It gave me nightmares, and the fact that I still remember it is testament to the impression it left on me.

A fall for Meta Platforms

All of which preamble leads to me observe that Mark Zuckerberg, Chief Executive of Meta Platforms (formerly known as Facebook), landed on the stock market equivalent of a nasty snake's head last week and watched his company's share price fall by 26.4% in one day. Admittedly, there have been bigger percentage falls in history, but none have resulted in such a spectacularly large loss of market capitalisation in one trading session ($237 billion – which is more than the combined market cap of two of the UK's largest companies, BP and Diageo).

Whether the scale of the fall was fully warranted is up for debate, although the lack of any sign of a bounce on Friday suggests a ruthlessly efficient market. The key point is that companies whose current valuations depend heavily on profits that will be generated well into the future remain highly vulnerable to any recalibration when those profit expectations are lower. Meta was caught in a nasty set of jaws, namely weaker-then-expected user numbers and rising costs, and joined other high-profile names including Netflix, Spotify and Peloton in the doghouse.

But volatility was not confined to the downside. Ladders were also available to some. Snap, the parent company of Snapchat, fell 24% on Thursday as the market feared the worst from its results, only to rebound a staggering 60% on Friday when the results turned out to be somewhat better than expectated. Amazon's shares enjoyed a similar, if not quite as extreme, round trip, falling 8% on Thursday before bouncing 14% on Friday. Of course, in market cap terms that was enormous too, with more than $200bn added.

Such moves are symptomatic of a period of transition, exacerbated further by indications of deteriorating market liquidity. Investors are grappling with the shift in monetary policy from ultra-loose to tighter; consumers are facing levels of price inflation not seen for decades; we're not quite sure if Omicron marks the beginning of the end of the pandemic; the geopolitical world order feels more unstable than it has done for years; and at the market level there has been a significant change of leadership from the new economy (technology and innovation) towards the old (energy and banks), possibly exaggerated by existing overweight positions in favour of the former group being reduced.

And as in a fractal design, there are layers upon layers of depth. At the highest level one can look at the divergence between long-duration/growth stocks and short-duration/value stocks, as we discussed last week. Another level down there is the separation of long-duration companies that generate profits today from those that don't. And then there is the difference between those that might be

close to a profitable inflection point and those that are not. Finally, there are those in the last group deemed to have enough cash in hand to have a fighting chance of becoming profitable and those that will run out of funds and be forced to recapitalise or go bust.

The cycle continues

Much of this feels a lot like the year 2000 to me, but with some crucial differences that continue to argue against the overall market meltdown predicted in some quarters. The similarities are that the market is in the process of sorting out the sheep from the goats. Buoyant liquidity and a speculative atmosphere created conditions in which pretty much all players were being valued as winners, which we know can rarely be the case. Total addressable markets just aren't big enough and competition is fierce, but the idea that one could spread a lot of chips around the table and that one of them would come up trumps was pervasive. And although it has worked quite well in the world of venture capital, one should remember that those players are getting in early and have a much deeper insight into the businesses they invest in.

Expectations are being reset to more realistic levels, but, as in 2000, there is still too much anchoring to past share prices and not to the underlying value of some of these businesses. It is this that perpetuates the "buy the dip" mentality: "If it was worth $40bn a few months ago, it must be cheap at $10bn". Not necessarily. The most experienced member of our asset allocation team recently rolled out the old phrase that it's not a bad time to "pay more to know more". In other words, let's allow things to settle down a bit, and if that means paying up for greater certainty of future returns, so be it.

The main difference between now and 2000 is that the market leaders are much more mature and embedded into daily life. They are highly profitable and generating bundles of cash from their operations. Yes, they are vulnerable to some derating, but we believe not to the extent that would be required to see markets halve, for example. And that's the US. The UK's market composition would appear to make it much less vulnerable, and the same goes for Europe, Japan and Emerging Markets.

It might well be that last week marked the peak of the latest bout of market volatility, especially as the big beasts of the US technology sector have now reported their results. Indeed, the US results season, which seems to play out a lot quicker than the UK and European ones, has not been at all bad in aggregate. With more than half of the members of the S&P 500 having reported (and more like three-quarters in market cap terms), the average company has beaten earnings expectations by 4.8%. OK, maybe not as strong as witnessed over the last few quarters, but supportive, nevertheless.

For the STOXX Europe 600 Index (which contains UK and European companies), the average positive surprise so far (with only a hundred or so having reported) is a similar 4.6%. It is also clear that earnings disappointments here are being punished much more harshly than positive surprises are being rewarded. Looking back through a couple of weeks' worth of our morning meeting notes, I can find either positive surprises or upper end of the range reports for several UK companies under coverage, including Compass, Diageo, Experian, Renishaw and Shell. They represent a pretty diverse set of industries, which is encouraging. And I'm struggling to find any big disasters.

As we have commented repeatedly in recent weeks, this year looks set to be a battle between the devaluing effect of higher interest rates and the earnings growth achievable by companies. Last week saw the interest rate ratchet being tightened a notch, with the Bank of England only narrowly deciding to raise the base rate by 0.25% rather than 0.5%. There have also been the first hints of a more aggressive approach emerging from the European Central Bank. But at least companies are holding up their side of the bargain for now. The first quarter (which we will see reported in late April and May) could be trickier thanks to rising costs, but the hope for more normal economic activity as Omicron fades also springs eternal.

Economic Commentary

FTSE 100 weekly winners

BP p.l.c.	5.3%
Vodafone Group Plc	5.2%
Compass Group PLC	5.0%
Standard Chartered PLC	3.9%
Smurfit Kappa Group Plc	3.6%
Standard Life Aberdeen	3.3%
Scottish Mortgage Investment Trust Plc	3.3%

FTSE 100 weekly losers

Antofagasta plc	-8.3%
Admiral Group plc	-6.7%
Johnson Matthey Plc	-6.1%
Next plc	-5.7%
AstraZeneca PLC	-5.5%
Kingfisher Plc	-5.1%
Ashtead Group plc	-4.5%

FTSE 100 index, past 12 months

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