Investec
Wealth & Investment

The Cruellest Month?

Calendric determinism is a common feature of markets. Probably the best known is "Sell in May", which I have investigated in the past. The "January Effect" is another example, suggesting that indices' direction in the first month sets the tone for the rest of the year. The "Santa Rally" is a seasonal favourite. One of the more reliable indicators in the past has been the US Presidential election cycle, although the current incumbent is doing his best to throw everything out of kilter. Around this time of year it is commonplace to read articles in the financial sections of newspapers (and also in on-line blogs, for the more progressive) asserting that October is the "cruellest month" for investors. They tend to proliferate if markets have a wobble, and so, unsurprisingly, the volume was cranked up last week. But is there any merit in the claim?

There is no doubt that a few bad things have happened in the month of October. These include the Wall Street Crash of 1929, which saw the Dow Jones Industrial Average lose 20.4% of its value (the peak-to-trough was -34.8%). Then there was the Crash of 1987, which saw the UK FTSE 100 Index fall a net 26%. Cementing the idea of decade-long cycles, October 1997 saw the FTSE 100 drop 8.5% as the Asian Crisis gathered pace; and, of course, the Great Financial Crisis of 2008 saw a 19.9% fall for the index in that month. The pattern was repeated last year, when the FTSE 100 fell 5% in response to escalating global trade tensions and tightening US monetary policy.

But these are the outliers onto which some have anchored their views. Looking at data for the FTSE 100 going back to its inception in 1984, the average return for October is +0.34%, with only ten of the thirty-five years producing a negative return. Of course, that's not to say that we can blithely disregard any risks this month, but, as always, we must judge everything on its merit.

I am (worryingly) frequently asked when the next financial crisis is coming, probably because the experience of 2008 is indelibly printed onto everyone's memory. There is also a suspicion - not wholly unfounded - that markets are structurally more vulnerable today owing to, for example, the nature of ownership (computer-driven strategies, Exchange Traded Funds, etc), and reduced liquidity because of tighter bank regulation. Some corners of the market are definitely pretty highly valued, notably some of the loss-making disruptors. There have been signs recently that this particular bubble has sprung a leak, but much of the damage so far has been confined to private investment funds having to mark to market. It's certainly difficult to describe many companies with a dependable growth outlook as looking cheap, but current valuations are not especially egregious when one takes into account an exceptionally low discount rate.

In fact, it's these low bond yields which underpin investors' search for anything with a reliable income stream. BCA Research highlighted this recently in an interesting way. They asked how much lower the UK stock market would have to be in ten years' time to leave investors worse off than if they bought a ten-year Gilt today and held it to maturity. This assumed reinvesting dividends, but that those dividends wouldn't grow at all. The answer was 60%, and this is down to the income gap. The 10-year yield is currently 0.43%, and the dividend yield on the FTSE All-Share Index is 4.9%. Of course, that doesn't preclude the ability to make shorter-term capital gains on the Gilt if yields press lower (possibly into negative territory). Also equities are going to be more volatile and we cannot rule out the potential for dividends to be cut. But there does appear to be plenty of uncertainty baked in. For the record, their calculations for other markets were as follows: US -20% (owing to lower dividend yield and higher bond yield); Japan -30%; and Europe -40%.

The continuing reach for low-volatility income was highlighted in an article in the Financial Times last week, which talked about institutional demand for retail property in the United States. Some funds are reportedly selling down both equities (too much volatility) and bonds (too little income) in favour of long-lease real estate. Apparently there is the small matter of $204 billion of "dry powder" waiting to be deployed.

Where could this all go wrong, justifying the fears of the doom-mongers? We would highlight two possibilities. The first is that investors perceive that central banks have lost any ability to support growth. This narrative has some credibility owing to the fact that economies have not exactly responded with enthusiasm to a decade of extreme policy, but the prospect of fiscal stimulus complemented by continued loose monetary policy suggests that the bullet chamber is not empty yet. The second is (geo)political interference/ineptitude – call it what you will. If the leaders of the world's two largest economies are prepared to sacrifice growth and stability in order to stick to their ideological principles, then there isn't much the rest of us can do but be caught in the crossfire. Our central view remains that neither side can afford extreme escalation, but it is impossible to rule out a more negative outcome.

The underlying lack of confidence was reflected to me at a large financial advisor conference last week. Over a hundred delegates were given a choice of five "Alternative Assets" in which to invest their granny's last £10. The choices were Gold, UK Value stocks, Song Royalties, Impact Investing and Alternative Credit. The winner, by a country mile, was Gold (with UK Value a respectable second). Hopefully that's a good contrarian indicator (although we continue to view Gold as a useful diversifier of overall portfolio risk). But even if the pessimism is justified and the bottom falls out of equity markets, it won't just be because it's the tenth month.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Ferguson	7.5%
Flutter Entertainment	6.2%
GVC Holdings	2.6%
Imperial Brands	2.6%
SSE	0.8%
London Stock Exchange	0.3%
SEGRO	0.1%

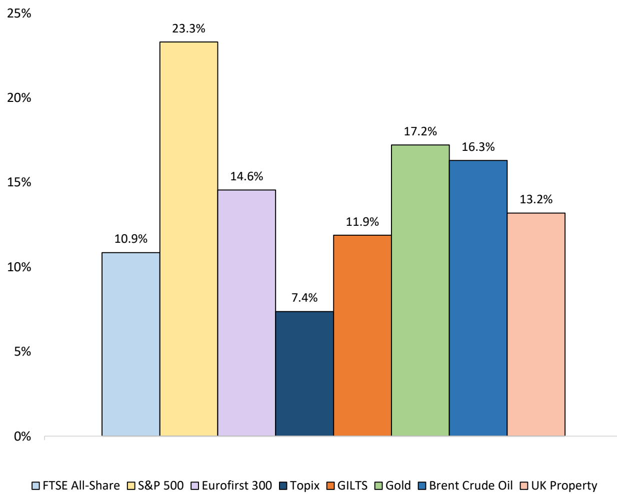
Source:FactSet

FTSE 100 Weekly Losers

Hargreaves Lansdown	-12.5%
NMC Health	-9.8%
John Wood Group	-9.7%
Evraz	-9.7%
Marks and Spencer	-8.6%
Glencore	-8.2%
Antofagasta	-8.2%

Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months

Source: FactSet

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