Investec

OUT OF THE ORDINARY

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The investment advent calendar

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I had what I thought would be a bright idea to create some kind of advent calendar, whereby investors could open the windows on a daily basis and discover a piece of market wisdom, investment knowledge or interesting snippet of information. Even allowing for the fact that my technology (let alone my handicraft skills, should I have designed a physical one) are not up to the task, I also realised that the state of markets at the moment is such that whatever was revealed by Christmas Day might be hideously out of date. I guess my challenge for next year is to gather twenty-five "timeless truths" of investing.

Even so, this week's Digest will be a bit advent calendar-like, in that there will be lots of tasty morsels, although, as with those calendars that dispense microscopic pieces of chocolate, you might have to scoff the whole lot in one sitting to feel properly satisfied.

10 December 2021

Let's get Omicron over with first.

The best "nutshell" analysis I have seen so far is from a viral immunologist in conversation with one of the investment banks. He strongly emphasised the waning nature of immunity and the need for vaccine boosters. He made a strong case for endemic COVID based upon its ability to mutate, promiscuity across species, and impermanence of human immunity (unlike, for example, with measles). Herd immunity will remain elusive and there will more variants and additional waves as long as there is a decent proportion of unvaccinated population. Zero-COVID strategies won't work. Yes, it's here to stay. More positively, he thought it would be very surprising if the virus "achieved the mutational hat-trick" of elevated immune evasion, transmissibility and virulence, because viruses usually give up something as they mutate further from their original form.

If one wants to focus on some dates, Pfizer is targeting December 10 for in vitro data on vaccine efficacy, while Moderna is suggesting the week beginning the 13. This will only be for neutralising antibodies, whereas, owing to the mutations on the spike protein, the T-Cell response could well be a more important marker. As for further UK government responses (with the accompanying risk of greater restrictions), December 18 seems to be the next date pencilled in, with another one on January 8 to assess the situation once we have been through the potential super-spreading events of Christmas and New Year. My colleague Jimmy Muchechetere told us about a Christmas Party in Norway where seventy out of one hundred and twenty revellers were infected with Omicron.

15 and 16 December 2021

Omicron is not the only factor bugging investors, though. As we have been discussing for a while now, central bank monetary policy is also a major factor, and here are two more dates to note: the next meeting of the US Federal Reserve's (Fed) policy-setting committee on the 15 and the same event for the Bank of England the following day. One doesn't need an especially long memory to recall the fact that it was the Fed's decision to crack on with policy-tightening in December 2018 that caused an abrupt sell-off for risk assets in the week up to Christmas – followed by an equally abrupt reversal of stance in January that catalysed a boom year for equities.

Bond markets are telling us that they are fearful of a central bank policy error. This is evident in the recent fall in bond yields and the flattening of the yield curve. In fact, as befits the retail frenzy in the run-up to Christmas, we could get two errors for the price of one. The first, largely baked in, was to underestimate the height and duration of the spike in consumer prices, something acknowledged by Fed Chair Jerome Powell in testimony before Congress last week when the word “transitory” was retired from the inflation narrative. Then, having got itself behind the curve, the Fed faces the risk of having to tighten more aggressively, resulting in a sharp economic slowdown.

To be fair the market is not in panic mode; it’s expecting a bearable cessation of asset purchases by March 2022 followed by close to three quarter-point interest rate rises by December and much the same in 2023. 1.5% interest rates should not be scary on a two-year view, especially if they represent an element of a return to normal. Perhaps where I note a change in tone is with respect to what has become known as the “Fed Put”. This is the concept that the Fed will step in and provide liquidity/cut interest rates as soon as there is any threat to financial market equilibrium. It was first observed in response to the Wall Street crash of 1987 (which you’d struggle to find on a chart these days). Its existence has provided a safety net for markets and encouraged a strong “buy the dip” mentality. But it has also existed during a prolonged period of disinflation when the Fed has been able to cut from a position of positive real rates. Now we are in a period of inflation with extremely negative real rates. Could the Fed’s hands be tied should, for example, Omicron turn out worse than hoped for? It’s certainly another factor to add to our list of reasons to be more circumspect in the short term.

Not for the first time recently, headline index moves fail to provide the whole story of last week’s equity market action. The MSCI All-Countries World Index fell 1.27%, but there were much more extreme moves beneath the surface, notably to the downside in what in some cases might only loosely be described as technology companies, but certainly those that have yet to achieve profitability. Goldman Sachs’s proprietary “Non-Profitable Tech” basket of stocks fell 14% over the five-day period. An index of Special Purpose Acquisition Companies dropped 6%. The bellwether ARK Innovation Exchange-Traded Fund lost 13%, and even Tesla’s shares finally capitulated with a 7% fall. But spare a thought for DocuSign, a Work-from-Home winner, which missed revenue expectations by the odd $10m out of almost $600m expected and saw its shares drop 42%.

There is a definite sense of money being taken off the table. Initially this might have been a sign of prudence in the face of the threat of tighter monetary policy and deteriorating economic expectations. Thus, hedge funds have executed the fastest de-grossing of positions seen for twenty years. But there are increasing signs of forced liquidation of retail positions too. This might account for the extraordinary moves in cryptocurrencies, notably Bitcoin. Bitcoin fell 9.7% to around $48,000 last week and was even as low as $42,000 at one stage on Saturday (it trades 24/7, although the market must be very thin at times). A report from MAN Group highlights that over the last decade when equities have fallen by 5% or more in one month, Bitcoin has also fallen on 86% of those occasions, with an average loss of 13%. This would seem to question the attractions of cryptocurrencies as diversifying assets during a risk-off phase.

I’ll just round off with a few snippets that you might not have caught. First, on the subject of supply chains, I spotted in some comments from the online home appliance and electrical goods retailer AO World that it had ordered twenty thousand iPhones and only managed to take delivery of 87.

1 December 2021

Next, a resounding cheer from the wealth management industry went up last week when the Treasury announced that the Office of Tax Simplification had kicked plans to align Capital Gains Tax rates with those for Income Tax into the long grass for the foreseeable future. It has been a source of potential stress every budget for a while now and would have had the potential to create some short-term volatility as well as to discourage long-term investment in some cases. However, I suspect it will return to haunt us at some point when a future government is strapped for cash.

2 December 2021

Finally, in the category of "you would have said I was nuts if I had predicted this two years ago knowing there was a pandemic on its way": The Office for National Statistics published data last week showing that UK household net worth grew by 8.4% in 2020 to £11.2 trillion. That's double the average of the last decade despite us going through the biggest recession for centuries. And I'll bet it's gone up some more this year, too. By comparison, net worth fell by 10% during the financial crisis. House prices were the largest contributor to the near £900 billion increase, followed by insurance policies, pensions and bank deposits. Insurance and pension schemes remain the largest pool of non-cash wealth at more than £4bn, followed by houses (£1.4tn) and other equity holdings (£1tn). This really was a recession like no other, which probably means that quite a lot of the rules of thumb that usually apply following recessions won't work either. This is not a time for lazy leaning on historical outcomes and correlations.

For all that this strong collective personal balance sheet is a good thing, there are a couple of concerns. First is that it has been even more concentrated into the hands of those who already had considerable asset wealth. Indeed, it is cited as one reason why more people have retired from the labour market altogether, creating a shortage of workers. This increase in inequality – because not every boat has been lifted by the tide – creates more social tension and political risk. Second, it will reinforce the feeling that there's no such things as financial risk for many because the government and central bank will always bail us out. That's the sort of mindset that tends to lead people to take too much risk with potentially painful future consequences.

Economic Commentary

FTSE 100 weekly winners

BP p.l.c.	7.3%
Royal Dutch Shell Plc Class A	6.1%
Berkeley Group Holdings plc	6.0%
Aviva plc	5.9%
Royal Dutch Shell Plc Class B	5.8%
Taylor Wimpey plc	5.7%
Barratt Developments PLC	4.6%

FTSE 100 weekly losers

Just Eat Takeaway.com N.V.	-14.3%
Ocado Group PLC	-11.1%
Hargreaves Lansdown plc	-7.8%
Scottish Mortgage Investment Trust Plc	-6.1%
J Sainsbury plc	-5.2%
Entain PLC	-4.9%
London Stock Exchange Group plc	-4.8%

FTSE 100 index, past 12 months

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