Weekly Digest

9 September 2019

The weekly insight into world stock markets

Investec
Wealth & Investment

Six Not Out

If only “6 Not Out” had been the final score of England’s last two batsmen yesterday, this morning’s sports headlines would have been quite different! As it happens, today marks six years to the day since I started work at IW&I. On average over history I should by now have experienced an economic recession and a proper equity bear market, but the current cycle has been anything other than average. Indeed, the US economic cycle and bull market are both in record territory for longevity.

Looking back through some old Weekly Digests it is abundantly clear that during the last six years there have been few occasions on which I have been unreservedly positive. There has always been something to be concerned about, perhaps proving the old saw that “bull markets climb a wall of worry”. Indeed, one widely followed contrarian sentiment indicator (from Bank of America Merrill Lynch) has just produced a “buy” signal with the S&P 500 Index within 2% of its all-time high!

Unsurprisingly, I have spent a lot of the time thinking and writing about politics, something I didn’t anticipate when I started. Although the word “Brexit” was coined in 2012 (according to the Oxford English Dictionary), it wasn’t common currency; Donald Trump was still fully engaged in his real estate empire; President Xi of China had been in power for less than a year and had yet to embark on his radical anti-corruption campaign; Italy was looking forward to a period of political stability following a resounding defeat for ex-premier Silvio Berlusconi; Emmanuel Macron was a little-known advisor to socialist President Hollande. Based on that potted history, could one really have much faith in anyone who thinks they know what the world will look like in 2025?

In my first Weekly Digest I suggested that “conventional bonds offer very little potential return”, and I have to admit that I was wrong (although I am far from alone in having made that claim). A broad UK Gilt Index has returned 43.45% over the last six years, which compares with a total return of 43.47% (!) for the broad UK stock market. Barring a brief period of synchronised recovery in 2017, the global economy has persistently failed to fire on all cylinders, which has led to much looser monetary policy than might have been expected, and the forces of demographics and technology have contained any inflationary pressures. Even so there were warnings during the “taper tantrum” earlier in 2013 that returning policy towards historical norms was going to be a challenge owing to accumulated levels of debt, and that is still very much the case today. In fact, this week the European Central Bank is forecast to deliver further interest rate cuts and to restart its Asset Purchase Programme.

One individual who has been monotonous in his prediction of ever-lower bond yields is Albert Edwards, the strategist at Societe Generale. Last week he updated clients on his “Ice Age” theory, and he continues to expect all developed market sovereign bond yields to go below zero during the next downturn. Where he has been less correct is in his prediction of an inexorable decline in equity valuations. What we have seen instead is an upwards revaluation of companies that can deliver any sort of growth in a sluggish economic environment, which is fully consistent with the mathematical effect on current valuations of a falling discount rate on future cash flows. He still expects the S&P 500 Index to trade below its 2009 low of 666, which would represent a fall of 70% or more from the current level. As that would entail an epic collapse of the financial system, it is definitely not a view that we subscribe to, as we believe that central banks and governments (however dysfunctional at times) have learned extremely valuable lessons from the financial crisis. As he and I are of a similar vintage, it is quite possible that we will both have retired before any definitive conclusions are reached.

Not far behind us in the age stakes is Boris Johnson, although his tenure as Prime Minister could yet be counted in days rather than years. At the weekend he managed to exceed the duration of Brian Clough’s notorious forty-four-day spell as manager of Leeds United FC in 1974, but he’ll have to make it past 20th November if he’s not to replace George Canning (who died in office in 1827) as the shortest-serving Prime Minister in history. Canning also gained the role without having to fight a general election. Interestingly, Canning’s elevation to PM (ahead of no less than the Duke of Wellington and Sir Robert Peel – will the likes of Gove, Raab, Leadsom, Stewart, Hunt, etc be recorded as prominently in history?) initiated a huge rift within the Tory Party.

It remains very difficult to make big portfolio calls based on Brexit, given just how uncertain the situation is, and when one has the ludicrous possibility of the PM calling a motion of no confidence in himself to try to engineer an election that the opposition doesn’t want to trigger despite years of calling for one. I have said before that when an election is called (and the odds currently favour one during November, with the UK having been allowed another three-month extension of Article 50) it will have little to do with traditional party politics. Whether Jeremy Corbyn sees it that way is another matter, but even if Labour do well it will not deliver him a mandate to implement radical socialist policies. The potential for tactical voting and regional pacts between Labour and the Lib Dems suggests that current opinions polls are even less useful than they turned out to be in the last election. The pound, which has risen from (briefly) below $1.20 to $1.24 is telling us that the probability of a “No Deal” Brexit is somewhat less than it was a week ago.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Melrose Industries	12.4%
NMC Health	10.6%
Royal Mail	8.8%
GVC Holdings	8.8%
Johnson Matthey	6.5%
Tesco	6.1%
Legal & General Group	5.7%

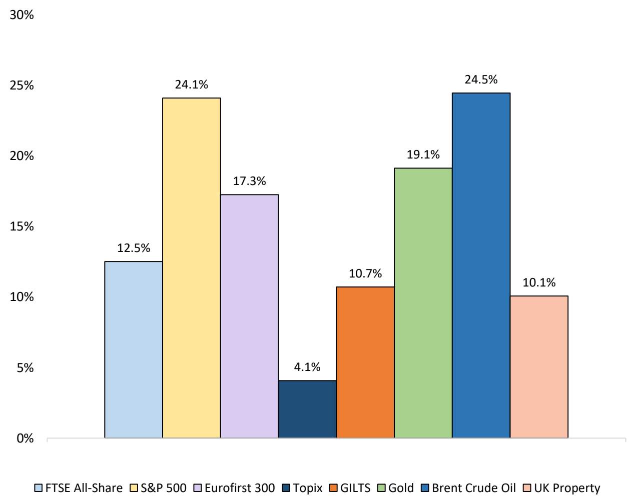
Source:FactSet

FTSE 100 Weekly Losers

United Utilities	-3.7%
Admiral Group	-3.4%
Barratt Developments	-3.1%
Fresnillo	-2.9%
Centrica	-2.6%
Severn Trent	-2.3%
Informa	-2.2%

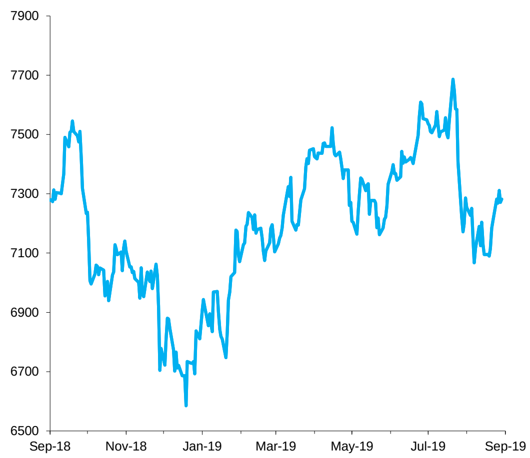
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet