Weekly Digest
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Investec
Wealth & Investment

The weekly insight into world stock markets

Schadenfreude (and other great German words)

Thanks to the ability to create compound nouns, the German language has many single words to express concepts that need a long sentence in English. Perhaps the best known is Schadenfreude – "taking pleasure in the misfortune of others". Ironically, non-Germans seem particularly chuffed when Europe's largest economy encounters difficulties. Last year there was global rejoicing at the national team's premature departure from the football World Cup. Now it is not difficult to detect some (inappropriate) international gloating at the recent travails of the German economy, which is currently flirting with recession.

And Germany is undoubtedly struggling at the moment. Growth expectations have decelerated rapidly since last summer. The Bloomberg consensus of economists' forecasts for GDP growth in 2018 has fallen from 2.5% to 1.5% (suggesting a possible technical recession in H2). For 2019 the equivalent measure has dropped from 2% to 1.35%. Last week the European Commission (EC) gave its official stamp of (dis)approval, cutting its 2019 growth forecast from 1.8% to 1.1%. Not that this is a problem specific to Germany. Perhaps more worrying, given that country's groaning public debt burden and unconventional government, was the EC's cut to Italy's 2019 growth forecast, from 1.2% to 0.2%. Its growth forecast for the whole euro area was reduced from 1.9% to 1.3%. Reasons given range from locally specific problems (more of which in a moment) to China's domestic slowdown, the US government shutdown and, naturally, Brexit.

Do we need to be alarmed? The good news is that the discounting characteristics of financial markets mean that much of this is already priced in. At its nadir, Germany's DAX Index of leading shares was 23.4% below its peak (currently still -18.6%). And even though the bad news is unlikely to reverse immediately, the pace of downgrades has probably peaked. No doubt this is somewhat dependent upon matters that are outside Germany's control, such as the outcome of US/China trade talks or Brexit (or a possible iceberg that we haven't spotted yet), but, on balance, we are of the opinion that both of these issues will be resolved without triggering crises.

Another thing that has held back the EU is the now long-forgotten strength of the euro. Over the year to February 2018 it rose from $1.05 to $1.25 against the dollar. That made its exports a lot less competitive. The euro has since given back half of those gains, which will have helped, but there is a lag to the effect. The slowdown in China also means that demand won't rebound quite as quickly as it might otherwise have done, but we remain confident that China's stimulus programme will begin to bear fruit within the next few months (See Weekly Digest 21/1/19).

Germany has also been hit hard by one-off factors. These include the changes to emissions standards for the automotive industry, for which manufacturers were woefully unprepared, and low water levels on the Rhine (affecting the transport of goods, components and even tourists), neither of which are going to exert a similarly large drag on growth this year. There was also an unexplained black hole in pharmaceutical production numbers. In a recent FT blog, Gavyn Davies estimated that these factors reduced Germany's annualised growth by 1.4% in the second half of 2018. If they normalise (as he expects) and there is some catch-up, growth in the first half of this year could be more than 2%. Cue widespread relief.

Germany has another important string to its bow, which is its fiscal position. With government debt at just 61% of GDP, and the country running a budget surplus, there is considerable scope to increase government spending, something which might go down very well in the current political environment. The new leader of the CDU party, Annegret Kramp Karrenbauer, has a golden opportunity to loosen the purse strings. With a huge (and growing) stock of domestic savings and a 10-year bond yield of just 0.1%, you have to ask: "Why not?"

The Chief Investment Officer of our South African business, Professor Brian Kantor, can see this opportunity clearly from almost 6,000 miles away: "[Germany] can borrow as much as [it] might wish at very low rates. Surely an extra bridge or highway, port or pipeline […] can promise a 1% per annum return? Governments with such favourable credit ratings neither have to undertake the construction nor the management of such low return projects that can be leased to private operators who win competitive tenders to do so. And if governments would exercise such opportunities to borrow more at invitingly low rates – also, heaven forbid, to cut income and expenditure tax rates - aggregate demand for goods and services would be stimulated. And businesses would add to their productive capacities, including their work forces. And depressed rates of growth of GDP and accompanying incomes would improve. Demand for credit, especially bank credit, would be encouraged, bank balance sheets would strengthen, while the national savings rates declined and interest rates could rise for very good reasons. Demand for capital to invest would be rising faster than supplies of savings. Less not more austerity is urgently called for in northern Europe - to help save the euro and the European project. The Italian and other populists are on the right track while the German fiscal conservatives perversely continue down a dead end."

Finally, as we enter another crucial Brexit showdown week, here are some more potentially useful German words: Fremdschämen: "the almost horror you feel when you notice that somebody is oblivious to how embarrassing they are"; Handschuhschneeballwerfer: "a coward willing to criticise and abuse from a safe distance" (literally a gloved snowball thrower). But don't be a victim of Kummerspeck: "excess weight gained from emotional overeating" (literally "grief bacon")!

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Compass Group	7.2%
Smith & Nephew	5.8%
GlaxoSmithKline	5.5%
BP	4.3%
3i Group	4.0%
Halma	3.9%
Rentokil	3.7%

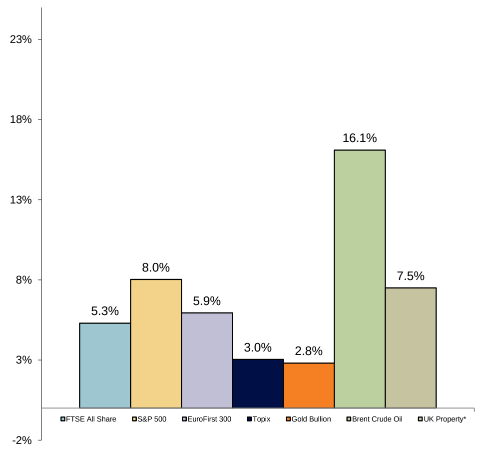
Source: FactSet

FTSE 100 Weekly Losers

TUI	-21.4%
Melrose	-10.4%
Ocado Group	-8.8%
John Wood Group	-8.5%
WPP	-8.5%
Associated British Foods	-4.8%
Glencore	-4.6%

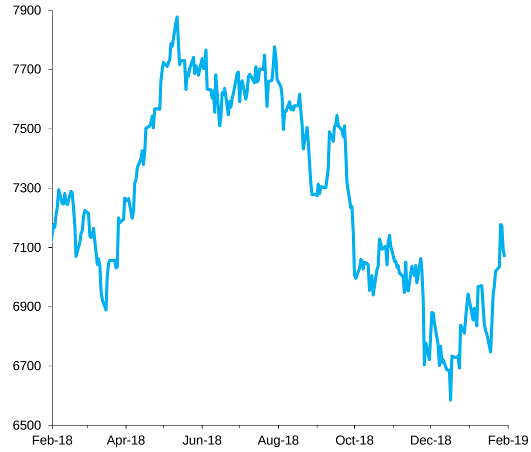
Source: FactSet

Year to Date Market Performance



Source: FactSet
*IPD Total Return to December 2018

FTSE 100 Index, Past 12 Months



Source: FactSet

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