Weekly Digest

13 January 2020

The weekly insight into world stock markets

Investec Wealth & Investment

…A New One Just Begun (And A Word On Iran)

I signed off 2019 with the first half of this line from John Lennon's Christmas song, Happy Xmas (War Is Over). When I was initially considering the title for 2020's opener it seemed wholly inappropriate because it looked as though war was anything but over. Indeed a new one appeared to be kicking off in the Middle East. Yet here we are a week later with equity markets hovering around recent (and in some cases all-time) highs and safe haven assets in retreat. There are a number of things we need to discuss pertaining to this episode.

First is the capacity of any event in the Middle East to rattle investors. Institutional memory is very deep, and it appears as though the scars of the early 1970s Oil Crisis have still not fully healed. Furthermore, conflict in the region in the late 1970s, the early 1990s and the early 2000s remains closely associated with economic downturns, although it's far from clear that any of them were caused primarily by higher oil prices. Respectively in those three cases: the Federal Reserve was already tightening the screws in the US; the US was suffering the fall-out from the Savings & Loans crisis and the UK was reversing a housing boom; we were in the full throes of the Tech Bust alongside the repercussions from 9/11. A spike in oil prices now would be more worrisome were other factors more negative, but central banks are currently in full-on easing mode and we continue to expect some of last year's negative growth factors (such as global trade) to moderate.

It's also fair to say that Middle East oil resources are not as critical to the global economy as they were fifty years ago. There are larger sources of alternative supply, notably the United States and Russia, and even, at the margin, the North Sea (which didn't really produce in great volumes until the mid-70s). Also, the world's economy is less oil-intensive than it used to be. Research from Deutsche Bank suggests that, almost fifty years on, we now consume two-thirds less oil per unit of economic output - and of course the aim is to reduce this considerably further in light of the climate change threat. We should also put the oil price move into perspective. In 1973/4 it quadrupled; in 1979 it doubled; in 1990 it rose two-and-a-half fold; from its 2002 trough to its 2003 peak it almost doubled. In response to President Trump's New Year strike it went up a little more than 7%.

I am suspicious (although would admit that I have no hard evidence to present!) that a lot of the initial trade that takes place around incidents such as these is driven by computers looking at headlines and past price reactions to similar news – the infamous algorithms that we hear so much about, many of which are based on historical correlation models. It can take a little longer for calmer heads to prevail, especially in the initial absence of clarity. In this particular case we were faced with having to get inside Donald Trump's head, which is something of a challenge at the best of times. The evidence of the past week suggests no appetite for escalation on either side, which echoes previous incidents with North Korea. You might recall that markets had a now barely perceptible wobble in August 2017 when Kim Jong-un started testing nuclear-capable missiles, but we have learnt to live with the threat. We have been living with various levels of conflict between the US and Iran since the 1970s. "Middle East Conflict" is a permanent feature on lists of potential "icebergs" that could sink the global economy. But since the first Oil Crisis, it looks more as if a rising oil price has been the "final straw" rather than the primary cause - always good to get a camel reference into a piece on the Middle East!

Another interesting take-away from this bout of nerves was the response of "safe haven" assets. We were particularly struck by the price of gold, which rose from $1,518 at the start of the year to a peak of $1,611 (+6.1%). Although it has since subsided (to $1,551 as I write), gold does seem to be regaining its lustre as the go-to asset for those seeking a bolt-hole. Other traditional favourites did not offer as much return. These include the Japanese Yen (+1.6% vs the dollar); the Swiss Franc (barely changed, although it rallied about 0.6% when Iran launched its own missiles); US 10-Year Treasuries (a yield drop of 22 basis points for around a 2% gain). Although gold continues to divide opinion (not only around the market, but also internally here), our Asset Allocation Committee is well disposed towards it. We note the increasing interest of central banks in holding the metal, with Russia and China to the fore, possibly as they seek to diversify from assets controlled by the US government. We also believe it adds a layer of protection against the potential for extreme monetary policies, especially those that might effectively monetise new government debts. We also note the increasing willingness of central banks to allow inflation to "run hot" in future to make up for past shortfalls relative to their 2% targets. Gold has traditionally been a useful hedge against inflation.

There has been a lot of speculation about Trump's motives in killing Qassem Soleimani. Should we just take it at face value that he represented a material present threat that had to be dealt with? Was it a tactic to divert attention from the impeachment process? Was it an election gambit? The latter explanations hold little water for me. The "main events" of impeachment are yet to come, so why distract so early? Same question for the election – it will all be ancient history by November. Perhaps the only thing we can be sure of is that there plenty of surprises left in this presidential term.

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FTSE 100 Weekly Winners

easyJet	8.5%
IAG	6.2%
Just Eat	3.9%
British American Tobacco	3.9%
GVC Holdings PLC	3.8%
Direct Line	3.0%
Ashtead Group	2.8%

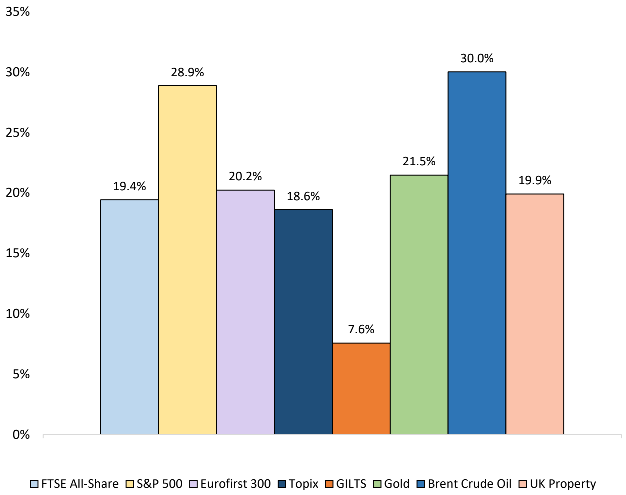
Source:FactSet

FTSE 100 Weekly Losers

NMC Health PLC	-22.9%
Marks and Spencer	-10.6%
British Land Company	-7.1%
WM Morrison	-5.6%
Standard Life Aberdeen	-5.6%
Fresnillo	-5.4%
Centrica	-5.2%

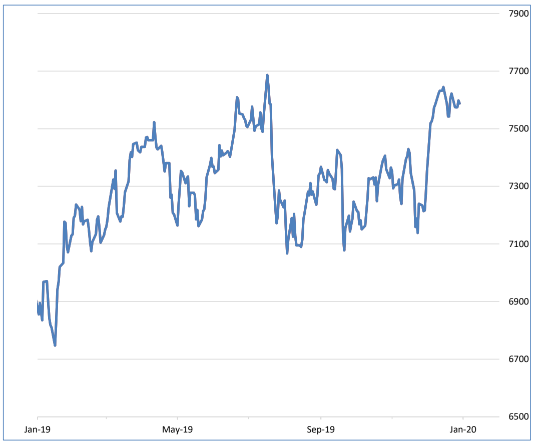
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet