Weekly Digest

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Investec
Wealth & Investment

The weekly insight into world stock markets

A Year To Forget

At this time of year it is traditional for letters such as this to reflect on the past twelve months - so here we go. There is no escaping the fact that, unless something extraordinary happens in the next two weeks, 2018 is going to go down in the annals of investment history as a peculiarly bad one. The average balanced portfolio is going to struggle to make a positive return, which in itself is not earth-shattering – it is the fact that pretty much every single asset class is going to show a negative return, especially if one takes inflation into account. According to the formidable number-crunchers at Deutsche Bank, this will be the worst year ever in their database (which I believe goes back to the 1920s) in terms of the percentage of global assets falling.

The single largest chunk of global investments is measured in US dollars, and our own data reveals that only Latin American equities (+0.4%), US High Yield bonds (+1%) and a basket of agricultural commodities (+1.9%) have registered positive returns in that currency, but have still failed to keep up with a headline Consumer Price Index rise of 2.2%. Investors in the UK who measure returns in sterling have had a few more positive asset classes to choose from, thanks mainly to the 7.3% appreciation of the dollar against the pound, but of course our global purchasing power has diminished. The UK Gilt market has put in a late burst of form, but this is the result of things we would prefer not to be happening: a weakening UK economy has reduced nominal yields, and the threat of Brexit-induced higher inflation has boosted returns for Index-Linked bonds. Even so, respective returns of 1.1% and 3.4% for the two classes is hardly shooting the lights out. The FTSE Private Investor Indices Balanced Portfolio benchmark is showing a decline of 1.1% for the year-to-date, which is hardly the festive message that I would be wishing to send out.

This outcome might look odd in light of the fact that it has actually been a decent year for corporate earnings growth. Aggregated data from Citi Research projects 16.4% global earnings per share growth in 2018, ranging from a stunning tax-cut induced 23% in the US to a disappointing -1.9% in Germany, where car manufacturers have struggled to cope with tighter emissions regulations and the effects of a stronger euro have crimped the translation of overseas earnings. The UK is on track to register 12.5% eps growth, but that has not stopped the FTA All-Share Index falling almost 12%. So why the poor showing from equity markets?

There appear to be three key reasons. The first is the gradual, but inexorable tightening of central bank liquidity. The US Federal Reserve is expected to raise interest rates by 0.25% for the fourth time this year on Wednesday, and for the ninth time since it started to normalise policy late in 2015. It is now also reducing the size of its balance sheet by $50bn every month. The European Central Bank confirmed last week that it will stop its own asset purchases at the end of December. Countries including the UK and Canada have also raised interest rates this year. If money is more expensive and there is less of it being created, that creates a headwind for financial assets.

Second is the enduring influence of politics. Whether we like it or not, politics is playing an increasing role in investment decisions. We have referred before to the forces that have helped to deliver Brexit, Trump and Italy's anti-establishment government, for example, and they show no sign of waning. If anything, the substantial minority who, with some justification, feel that they have been severely deprived of the supposed benefits of globalisation and the asset-enhancing powers of post-financial crisis monetary policy, are increasingly making their views felt. This is encouraging a more nationalist direction to policies as well as a clamour for greater redistribution of wealth and, in some areas of the Technology sector, for example, tighter regulation. It is very hard to see these trends reversing soon.

Related to all of this is Donald Trump's personal crusade against China (aided and abetted by several members of his coterie and not exactly opposed by the Democrats). Although it is dressed up as a fight to balance trade between the two countries, the reality is that it reflects the existential threat that America perceives from the increased political, economic, technological and even military rise of China. Again, this doesn't get resolved quickly or easily.

Finally (and definitely not exhaustively) asset markets are fulfilling their traditional role as canaries in the coalmine, sniffing out the threat of future recession and beginning to discount it in valuations. Equities have suffered a big derating this year, the sort of move usually associated with bear markets and/or recession (neither of which have yet happened). Back in January the 2019 forward PE for global equities was 14.8x. Now it is 13.4x.

The Big Question for us is whether or not a recession will arrive within the next year or so, and our current assessment is not, although growth is set to decelerate. The market currently sees global corporate earnings growth of 8-9% in 2019, and even if that is probably a touch high, combining it with a near-3% dividend yield suggests the potential for modest positive real returns, although the threat of a sharper slowdown, continued political interference and the ongoing tightening of liquidity mean that increased volatility will remain a feature.
Now it just leaves me to thank you for taking the time to read these missives and to wish you and your families a Merry Christmas and a prosperous and healthy 2019.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

GVC Holdings	7.8%
WPP	6.6%
Ashtead Group	5.8%
Bunzl	5.4%
Anglo American	5.4%
BHP Group	5.3%
TUI	5.0%

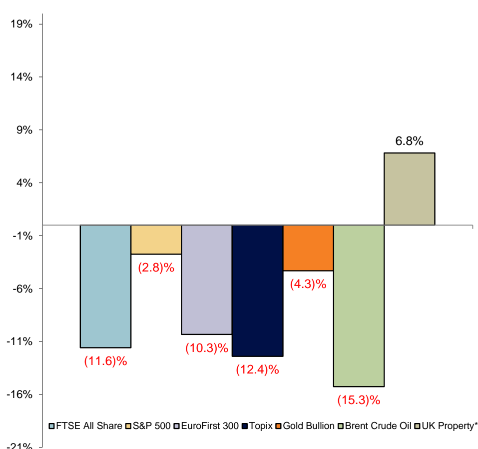
Source: FactSet

FTSE 100 Weekly Losers

John Wood Group	-9.6%
J Sainsbury	-8.2%
Next	-7.2%
Marks and Spencer	-6.7%
Barratt Developments	-4.8%
Evraz	-3.6%
NMC Health	-3.2%

Source: FactSet

Year to Date Market Performance



Source: FactSet

*IPD Total Return to October 2018

FTSE 100 Index, Past 12 Months

Source: FactSet

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