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Wealth & Investment

Wallowing in Nostalgia

There's plenty going on at the moment, but nothing particularly conclusive. For global investors, the trade talks between the US and China are the main driver of short-term risk appetite, and they have been "ongoing" for what feels like an eternity; in the UK, the twenty-four days between now and the election will seem equally interminable. To make matters worse, little will be fully resolved by any outcome. The trade dispute is only one facet of the increasingly strained relationship between the US and China; and even if the UK election does finally trigger the Withdrawal Agreement, we still face months (years?) of negotiations over a trade deal.

The world's equity markets appear blissfully unconcerned, concentrating on the positives. These include the hope that the negative effects of the trade disputes are now beginning to flatten out, the relatively decent third quarter reporting season, the increased liquidity support being provided by central banks, and the prospect of greater fiscal stimulus.

The S&P 500 Index ended last week at an all-time high, and is now up 24.5% this year, which is a great performance even allowing for the fact that it started from a depressed base following the big sell-off in the final quarter of 2018. Germany's DAX Index and France's CAC Index are both +25.3% as I type. China's CSI 300 is just a whisker away from being up 30%. The notable laggards start with Japan's TOPIX (+13.8%), and then three countries that are mired in ugly politics stand out – the UK (FTSE 100 +8.5%), Spain (IBEX +8.4%), and Hong Kong (Hang Seng +3.2%). Brenda from Bristol could well spare a thought for Maria from Madrid who has had to endure two general elections this year (four in four years), and where the new left-leaning coalition only hangs together in its desire to repel the far right. All of the index performances quoted above are in local currencies, and so the performance of the UK looks a little better when measured in dollars, for example, thanks to the pound's recent recovery, and, by the same token, the European indices look a bit worse thanks to the weaker euro. But the broad league table looks much the same.

Of course, indices are made up of companies, and from a "bottom up" perspective, the news has been better of late. In the US, which accounts for over half of the world's equity market capitalisation, 461 of the 500 companies in the main index have reported their quarterly earnings. Even taking into account the propensity to play down expectations with a view to beating them, an 80% positive surprise ratio has been well received, although 2019 overall looks like being a year of limited growth – just 1.7% according to Bloomberg, against +6% expected back in January. The global earnings aggregate forecast is in fact slightly negative, a far cry from the +7.5% pencilled in at the start of this year. There again, 2018 was a year of net upgrades to earnings expectations, and equities were down, confirming that, in the medium term at least, earnings are not necessarily the key driver of markets.

This year's equity returns have largely been driven by re-rating, which can only go so far. Some of that is down to the falling discount rate, which has pushed up the valuation of Growth stocks. And some is liquidity-driven, as investors seek a home for savings that offers a half-decent income. I came across a chart from Bank of America Merrill Lynch's strategists recently which provided a timely reminder of the importance of income. It showed that, since 1960, 83% of the return of the S&P 500 Index was driven by dividends.

It's a relief to stop thinking about all this work stuff sometimes, and so there was much rejoicing at home yesterday at the return of the Netflix series The Crown. But then, of course, I started thinking about the investment implications! Netflix has been an extraordinarily successful investment since making its market debut in 2002 distributing DVDs (!), delivering a capital return of 27,436%, which is to say that $1,000 invested on day one would be worth $275,360 today. In this case, just to challenge the assertions made in the previous paragraph, the total return is exactly the same, because the company has not paid any dividends, preferring instead to channel all of its resources into acquiring and now creating content. This strategy can definitely work for a long time, and Amazon is a company with a similar profile (here your $1,000 would have grown to be worth $1,159,660 since the IPO in 1997, again with no dividends being paid). The aim of both companies is to maximise market share and build a strong defensive moat around the business before contemplating letting shareholders see any actual cash.

In the case of Netflix, the key to driving subscriber growth is content. In the case of The Crown, this is produced by Netflix itself, and the latest series is reported to have cost somewhere north of $150 million. My own back-of-the-envelope numbers suggest that, somewhere during the making of the fifth season, the cumulative production costs of The Crown will surpass the net worth of the Queen herself! That will be fine as long as there are enough subscribers. The company also buys in content, and recently paid a rumoured $500 million for the five-year global rights to the comedy series Seinfeld, the last new episode of which was broadcast in 1998. This is deemed to be evergreen "must see" content, as attractive to younger viewers who weren't even born when it first aired as to die-hard fans and nostalgists. It will replace Friends and The Office in the US, which have been reclaimed by their original producers. With the proliferation of competing platforms including Amazon Prime, Apple TV+, HBO Max and NBCUniversal flexing their muscles, the old media mantra that "content is king" looks truer than ever.

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FTSE 100 Weekly Winners

Royal Mail	5.6%
Royal Bank of Scotland	5.5%
United Utilities	5.4%
Burberry Group	5.3%
Lloyds BG	5.1%
Persimmon	5.1%
SSE	4.7%

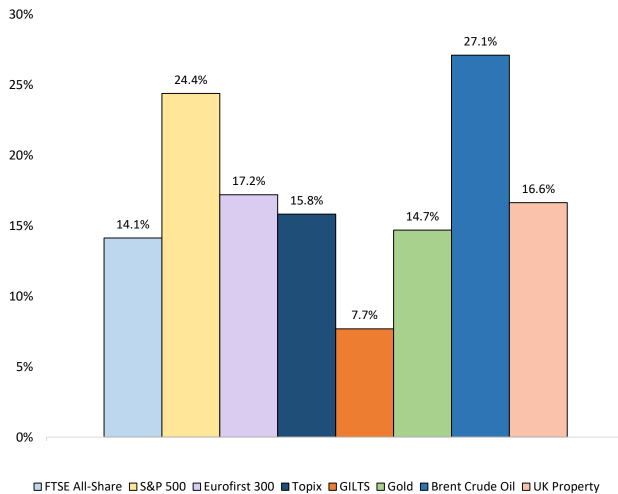
Source: FactSet

FTSE 100 Weekly Losers

DCC	-10.7%
Fresnillo	-7.3%
3i Group	-6.7%
Rolls-Royce	-5.6%
Antofagasta	-5.4%
Vodafone Group	-4.7%
Marks and Spencer	-4.5%

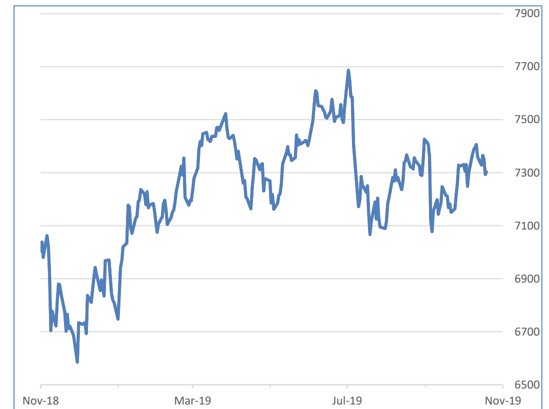
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet

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