Weekly Digest
25 February 2019

Investec
Wealth & Investment

The weekly insight into world stock markets

Has Spring Sprung?

Unseasonably warm weather and record temperatures before the end of February tempt one to believe that winter is over and spring is here. This feeling is encouraged by the flowers appearing on my forsythia and the burgeoning buds on the magnolia tree. But it is not unknown for further cold snaps to occur, such as last year's (after the "Beast from the East") which killed my photinia "Red Robin". Financial markets have had a spring in their step lately, so the big question is whether or not we are witnessing a false dawn. This will be dependent upon a number of factors, some of which are proving to be difficult to predict.

For global investors, monetary policy and trade developments remain the key areas that will influence both economic activity and market sentiment. Here in the UK, Brexit will continue to dominate the news, but it might also play a larger part in the fortunes of the Continental European economy. Recent weakness on the other side of the Channel leaves Europe with less of a cushion in the event of severe Brexit-related disruption.

It seems hard to believe now that the fourth quarter of last year was characterised by fear that the US Federal Reserve Bank was going to strangle the life out of the US economy, but that was very much the case following hawkish comments by chairman Jay Powell early in October. This sentiment was bolstered by the statement that accompanied the quarter-point interest rate increase on December 18th, which appeared to endorse an "automatic pilot" approach to policy (but with the flight path set for a nasty impact). Cue the sharp sell-off for risk assets heading into Christmas. As discussed in the Weekly Digest on 7th January (Back to Business), investors began to invoke the power of the "Fed Put", and once again it appears to have put a floor under equity and credit prices.

Indeed, of the uncertainties listed above, it now looks as though we can take most comfort from the monetary policy outlook. Not only has the Fed taken interest rate rises off the agenda for now, but it is also actively considering curtailing the reduction in size of its balance sheet – so called "Quantitative Tightening" – much sooner than expected. This would leave considerably more liquidity in the financial system than feared, and bolsters the bullish argument for those who believe that it is the "stock" of liquidity which is important rather than the "flow". As I do not have a formal economics training, I have to defer to greater minds on this debate, but my interpretation is that the "stock" plays a much stronger role in the smooth functioning of the financial system, while the "flow" tends to have a more direct impact on financial assets. So an early end to balance sheet reduction is unequivocally good news on both fronts.

Of course, pumping liquidity into the system does not guarantee strong economic growth. A remarkable fact is that during the period that the European Central Bank (ECB) undertook €2.5 trillion of Quantitative Easing, the region's banks only increased their lending by just over €600 billion. Some of that was down to the need to rebuild capital bases, some of it to a lack of demand for credit. The ECB terminated its QE programme at the end of 2018, but has no plans to reverse it, at least. However, there is another, more technical, element of liquidity in the European banking system, and that is the provision of loans by the ECB under its targeted long-term refinancing operations (TLTRO). These loans encourage banks who access them to lend more by reducing the interest rate as the amount of lending grows. However, much of the current stock (in excess of €700 billion), expires in 2020/21 and would have to be replaced by more traditional sources of finance such as deposits or wholesale funds, which would almost definitely be more costly (if available at all). The ECB appears to be alive to this threat of reduced liquidity (and possible squeeze on banks' margins), especially as the biggest users are Italian banks. Whether TLTROs are rolled over or replaced by some new facility remains to be seen, but it currently appears unlikely that the ECB will pull the rug out from under the financial system.

The two other central banks that really matter (sorry, Governor Carney) are the Bank of Japan and the People's Bank of China (PBoC). The former is still running a QE programme, but at a reduced rate. There is no expectation of this being halted, much less reversed. China's central bank has not indulged in any of the esoteric policies of its developed world peers, and tends more to lean on the state-controlled banking system to proffer loans. Even so, the PBoC's balance sheet is pretty much exactly where it was at the start of 2018, offering some evidence of the ongoing squeeze in that economy, and at least partly contributing to last year's market turmoil. We continue to believe that the government is easing off the brakes, although evidence of stronger demand might not start to show through for a few months yet.

The biggest threat to continued monetary indulgence is most probably sharply higher inflation, of which there continues to be little evidence, but we remain on alert for a spike in wage growth in particular.

Were auguries of spring to be purely dependent upon monetary policy, it would be easier to declare the season upon us. However, trade and Brexit negotiations are still in progress, although (at least in theory) with pre-determined dates for a resolution - March 1st in the case of the US/China trade talks, and March 29th for Brexit. There has been a positive reaction to the latest Trump statement on China overnight, although a deal is not guaranteed.

Finally, the heavy metal band *Saxon* was formed in the Yorkshire town of Barnsley. This week, which former international cricket umpire was born in Barnsley in 1933?

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Micro Focus International	11.0%
Antofagasta	8.3%
Next	5.7%
Anglo American	5.4%
Severn Trent	4.4%
United Utilities Group	4.4%
Kingfisher	3.6%

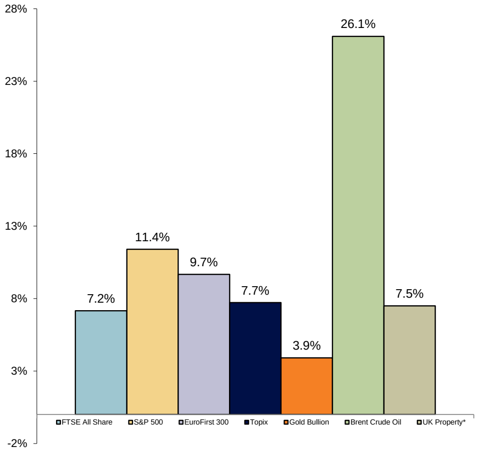
Source: FactSet

FTSE 100 Weekly Losers

J Sainsbury	-18.4%
Centrica	-10.9%
BAE Systems	-10.7%
HSBC Holdings	-6.4%
DS Smith	-5.7%
Standard Chartered	-4.5%
Smurfit Kappa Group	-4.0%

Source: FactSet

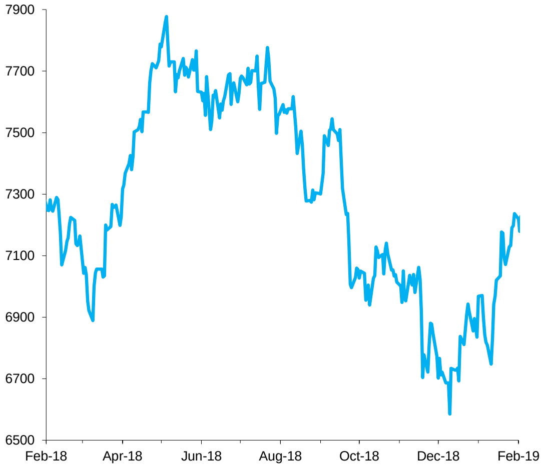
Year to Date Market Performance



Source: FactSet

*IPD Total Return to December 2018

FTSE 100 Index, Past 12 Months



Source: FactSet

investecwin.co.uk
Member firm of the London Stock Exchange. Authorised and regulated by the Financial Conduct Authority.
Investec Wealth & Investment Limited is registered in England.
Registered No. 2122340. Registered Office: 30 Gresham Street, London EC2V 7QN.

IWI740 v1