| 26 October 2020 |

John Wyn-Evans
Head of Investment Strategy

The Fall

“Spring forward, Fall back” is a handy mnemonic for those who struggle to remember which way to reset the clocks as we enter and leave British Summer Time. Of course, it does require the use of the version of the season now favoured in North America, which grates with many on this side of the Atlantic. And although the use of “Autumn” is not unknown over there, they are less likely to employ the adjective “autumnal”, with its evocation of long walks through piles of fallen leaves followed by a Sunday Roast in a pub with a crackling log fire. Well, that’s something to reminisce about in these Covid-blighted times, and hopefully something to look forward to again in the future.

Seasonality is a factor often cited for the performance of stock markets. We have written on more than one occasion in the past about the “Sell in May” philosophy, for which there are several plausible reasons, and which does have a reasonably good track record. Another old favourite is the “Santa Claus Rally”, in which shares trade higher into the year-end. This can then be followed by the “January Effect”, which claims that the direction of markets in January sets the tone for the rest of the year.

A few pieces of research have dropped into my inbox recently pointing to the relatively poor average performance of markets in the August-to-October period, with the promise that returns are set to improve once we get past Hallowe’en. Indeed, one from Ned Davis Research, sourcing data back to 1987, graphically illustrates that, on a rolling three-month basis, October to December has provided the most generous returns for investors in the MSCI All-Countries World Index (closely followed by November to January).

Naturally, none of this guarantees that this year will reflect past performance. This sort of analysis highlights a tendency rather than making a rule, and averages can hide some big outlying outcomes. As Jim Grant, long-time editor of the eponymous “Grant’s Interest Rate Observer”, asks when attempting to unravel the peculiarities of the current economic, corporate and monetary situation, “My body temperature may, on average, be normal if my feet are in the freezer and my head is in the oven, but is that healthy?”

Another set of data doing the rounds at the moment looks at the past performance of US equities under either Republican of Democrat administrations. As you might imagine, this is highly topical as we are now entering the last week of campaigning ahead of the US Presidential election. Intuitively, one might think that the Republican Party, which characterises itself as more “business friendly” and a supporter of free markets, would be the investors’ choice - but historical averages, taken at face value, at least, do not support that view.

Investec

Using data going back to 1871, MRB Partners calculates that Democrat presidents have delivered average annual returns of 7.5%, versus Republicans managing just 5.2% (and it doesn't appear as though making allowances for inflation makes much difference). The disparity in median returns is even greater, standing at 10% vs 4.5%.

Looking just at the period since 1965, SocGen's strategists show that the average return over a Democrat presidency is a whopping 40%, versus just 15% for the Republicans. So a slam dunk for the Democrats, then? Not so fast.

The averages are skewed by some particular outliers. The S&P 500 more than doubled during the Bill Clinton years, but he did have the advantage of being at the reins from a period when the US was emerging from a recession and the aftermath of the Savings & Loans Crisis. He rode the cycle all the way up to the peak of the Tech boom, which featured the highest market valuations ever achieved. The US Treasury was awash with cash, to such an extent that the Chief Economist at Lehman Brothers wrote a piece in 2000 pondering how the government might choose to disburse trillions of dollars of budget surpluses over the next decade. There was serious talk that bond markets could be effectively shut owing to lack of supply. Wouldn't that be a nice problem to have now!

George W. Bush had the misfortune to take control at the market peak and to depart pretty much at the nadir of the Financial Crisis, and he was followed by Barack Obama who arrived just as stimulus packages were being approved and the Federal Reserve was embarking on the most expansionary monetary cycle in history. Obama oversaw another doubling of the market. Trump, thanks mainly to his generous tax cuts, was tilting the scales back in favour of the Republicans, but was undone by Covid.

Whoever ends up sitting in the Oval Office in January faces pretty high historical market valuations, although we continue to believe nothing like as egregious as in 2000. He will also inherit interest rates and bond yields that are at historical lows and which will struggle to provide further valuation impetus. And that's before we layer in the ongoing difficulties of managing Covid.

Polling organisations and the people who analyse those polls remain of the opinion that Joe Biden is a clear favourite, although I note that betting markets are less certain. A case of "once bitten", perhaps, after 2016? Investors are tentatively putting a few chips on the table, and we have seen the beginnings of a rotation into previously less favoured areas of the market. Small cap stocks have done better recently at the expense of the mega-caps, for example. I would hesitate to call this a "Value Rally", although I can guarantee that this is the label that will be widely attached to it if it persists. I would characterise it more as recovery of "short-duration" earnings over "long-duration".

This is the result of potentially greater certainty about shorter-term growth potential, something that would be boosted by a US fiscal stimulus package and other Democrat policy initiatives. A working Covid vaccine would be icing on the cake. Even so, this could be yet another rotation to "rent" rather than to "own", with much depending on the ability of economies to accelerate beyond the more sluggish growth trends of recent years.

One reason that investors refuse to go "all in" on the Democrat stimulus trade is that there remain too many uncertainties, notably over the risk of a contested election. Goldman Sachs suggests short-term gains of 6.5% for the S&P 500 and 9.6% for the Russell 2000 (small cap) index in the event of a Democrat clean sweep of the White House and Congress, but losses of 9.4% and 10.3% respectively if the result is contested for what might be a period of several weeks. There are similar implications for volatility in bond and foreign exchange markets, although not as severe.

But, as I have mentioned before, everything should be settled by Inauguration Day (20th January) at the latest. We should also have clarity on Brexit by then. Will it really all come down to fish? Just that pesky virus to deal with then… I'm sure we'll find something else to worry about!

Last week's Economic Highlights

FTSE 100 Weekly Winners

International Consolidated Airlines	13.8%
Informa PLC	10.4%
Rolls-Royce Holdings PLC	9.8%
Barclays PLC	9.6%
Natwest Group PLC	8.5%
Lloyds Banking Group PLC	8.4%
Standard Chartered PLC	8.0%

FTSE 100 Weekly Losers

Fresnillo PLC	-9.3%
Just Eat Takeaway	-8.1%
Ocado Group PLC	-6.0%
DCC PLC	-6.0%
Pearson PLC	-5.8%
GVC Holdings PLC	-5.8%
DS Smith PLC	-5.7%

FTSE 100 Index, Past 12 Months

Source:FactSet

The information in this document is for private circulation and is believed to be correct but cannot be guaranteed. Opinions, interpretations and conclusions represent our judgement as of this date and are subject to change. The Company and its related Companies, directors, employees and clients may have position or engage in transactions in any of the securities mentioned. Past performance is not necessarily a guide to future performance. The value of shares, and the income derived from them, may fall as well as rise. The information contained in this publication does not constitute a personal recommendation and the investment or investment services referred to may not be suitable for all investors; therefore we strongly recommend you consult your Professional Adviser before taking any action. All references to taxation are based on current levels and practices which may be subject to change. The value of any tax benefits will be dependent on individual circumstances.

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.

Investec