Weekly Digest
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Investec
Wealth & Investment

The weekly insight into world stock markets

Red Monday

What Blue Monday? I'm as happy as a lark! Another week rolls by and we are not much wiser about the outcome of Brexit withdrawal negotiations. If I really believed that something substantive was going to come out of Mrs May's Plan B proposals I might have waited till tomorrow before putting pen to paper, but expectations are low. And the fact that the next parliamentary vote is not until the 29th January means that I am unlikely to be able to shed a lot more light next week either! What is becoming clear is that Brexit politics and party politics are moving along increasingly divergent tracks – how else could one explain the largest defeat in living memory for an incumbent government followed twenty-four hours later by a motion of no confidence also being defeated? Historians are reminding us that Ted Heath only managed to get the UK into the European Economic Community with the help of a group of Labour MPs. Once one gets away from the emotional effect, this is fascinating stuff.

Most instructive last week was the reaction of the pound to the votes. While off its peaks, it is a couple of percent higher from its 2019 lows against most major currencies as traders price in the lower probability of a "No Deal" Brexit. However, given the lack of certainty, sterling remains roughly in the middle of the range projected by most analysts for the best (Supersoft or No Brexit) and worst (No Deal) outcomes, which extends from $1.15-1.20 up to $1.40 or so against the dollar. Certainly the asymmetric downside risk to sterling that was apparent before the referendum and again early in 2018 is not currently present.

Maybe the UK's travails are also looking somewhat less worrisome on a relative basis, with evidence of stress emerging in the rest of the world - stress which markets, in their prescient way, sniffed out last year. The US government shutdown, now the longest on record (but possibly not a record that Donald Trump is going to brag about) is beginning to have effects on real economic activity. One realises just how perilous existence is for large swathes of the US population when pay checks don't get sent out for only a few weeks. There is also a well-documented slowdown in parts of Europe, not least in Germany, where the country's dependence on global trade is being exposed.

This morning's business headlines focus on China's growth in 2018 (hence "Red Monday"), which is being reported in tones that reflect what feels like a mix of fear and schadenfreude. What western leaders would be willing to give for 6.6% annual growth doesn't bear thinking about, but for China this represents the slowest pace of expansion since 1990. And I would dare to say that the reality is even slower than that, given that it is generally accepted that these numbers are massaged to arrive close to the government's targets.

But that is not necessarily a cause for alarm. Markets have again been running well ahead of these developments. The Shanghai Shenzen CSI 300 Index of leading Chinese companies is currently trading 27% below it 2018 peak and at levels not much higher than were seen at the lows of early 2016, when investors last feared a "hard landing" for the Chinese (and world) economy. Although there are undoubtedly effects being felt from the trade dispute with the US, much of China's slowdown is self-inflicted. As long ago as the second half of 2016 the government started to rein back its previous stimulus, fearing the potential for another speculative bubble in the property market. This was prudent management. Equally sensibly it tried to set the country on a path towards more balanced and sustainable growth. This entailed, for example, curtailing the less regulated lending practices of the "shadow" banking sector (where loans were easy to obtain, but often with usurious interest rates), reducing notoriously high levels of pollution, and shifting the growth emphasis from capital expenditure towards consumption. As is the case when turning a supertanker, it took quite a long time for these measures to have a visible effect. And once the ship is turning, it takes quite a lot of skill to stop it overshooting. And (from my own smaller scale memories of navigating the racing tides of the Menai Straits) you have to start turning a long way out from your intended destination.

The captains of the Chinese economic ship have been leaning on the tiller for several months now. For example, they started cutting the Reserve Requirement Ratio for banks last April. That move and three subsequent cuts have taken it from 17% to 14%, freeing up a lot more money to be lent out. Interest rates have also been cut for small business. However, the appetite for loans has been weak alongside falling consumer confidence (which has been apparent in data such as auto and iPhone sales), so more measures have been required. These include fiscal initiatives, such as lower personal tax rates, allowing certain household expenses to be offset against taxable income, and a tax cut for small businesses. A reduction in the VAT rate is also under consideration, as are trade-in incentives. These will take their time to have an impact, but, given the government's intentions and the already poor market performance, now is not the time to start panicking. Of course, the external influence of Donald Trump and his trade tariffs cannot be ignored, but they are a separate issue. China is taking all the measures required the draw a line under this domestic cyclical slowdown, and will do more if needs be. Those predicting a "hard landing" look as though they will be disappointed again.

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FTSE 100 Weekly Winners

Royal Bank of Scotland	8.8%
Persimmon	8.7%
United Utilities	8.6%
Taylor Wimpey	7.1%
Just Eat	6.6%
Barratt Developments	6.3%
Lloyds Banking Group	6.0%

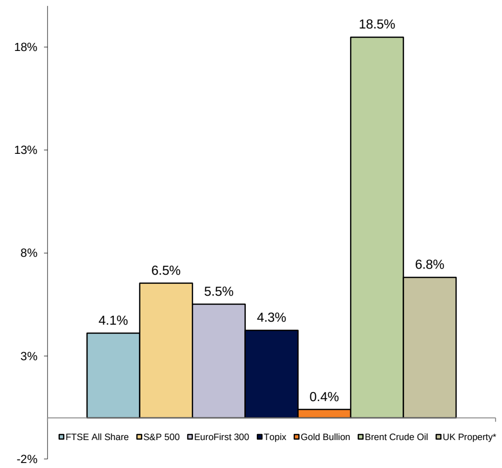
Source: FactSet

FTSE 100 Weekly Losers

Pearson	-9.9%
John Wood	-6.8%
Fresnillo	-5.2%
ITV	-4.5%
Paddy Power Betfair	-4.4%
Evraz	-3.7%
Reckitt Benckiser	-3.2%

Source: FactSet

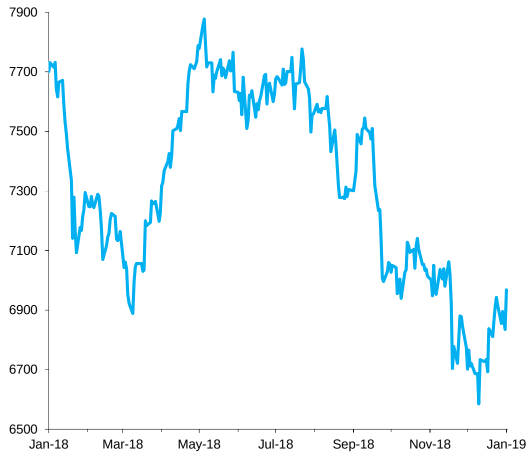
Year to Date Market Performance



Source: FactSet

*IPD Total Return to October 2018

FTSE 100 Index, Past 12 Months



Source: FactSet

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