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2024 – Not 2016, Not 2020

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Four years ago, I came up with the concept of the "BVB Trade". It was during the autumn of 2020 and investors were constrained by three major elements of uncertainty. The biggest of the three was the "V" for "vaccine". Hard as it seems to remember now, Covid-19 was still a big threat and there was no hard news about the development of vaccines – and certainly not about how effective they might be. The first "B" stood for "Biden" as we headed towards the 2020 US Presidential election with a feeling that markets would prefer the more level-headed approach of the challenger. The second "B" was for "Brexit", the final terms of which had yet to be fully resolved, although negotiations were aimed at getting it over the line by the end of the year.

Markets tend to dislike uncertainty, and I judged that some clarity on these issues, which did not necessarily have to be investors' preferred outcome, would allow markets to find some direction. The MSCI All-Countries World Index (ACWI), having peaked at the beginning of September following the initial "we're not all going to die" rally from March's lows (and propelled by unprecedented amounts of central bank liquidity and debt-financed government handouts), had been in something of a holding pattern for a couple of months, giving back around 7% of the previous gains. Just to remind you of how volatile equity markets had been, by the end of October 2020, the ACWI was +43% from its March low, but still marginally down for the year.

The US election was held on November 3rd that year, and although Joe Biden had the Presidency in the bag, there was still the small matter of the Georgia Senate race to be resolved. This went to a run-off in January 2021. Even so, equities were beginning to rally. But it was the announcement of the Pfizer/BioNTech vaccine on 9th November that was the real catalyst for the next leg of returns.

The transformational nature of the news is captured in the share price of Carnival Cruise Lines, an archetypal "going out" stock (as opposed to the "stay at home" shares which had been doing so well previously). Its shares closed up 39% on the day, and even though they succumbed to some profit-taking in the next few days, further recovery over the next six months delivered gains of 154%. I'm not sure that cruise ships and rollercoasters go together, but the Carnival price chart since the beginning of 2020 is extraordinary. There was an 84% share price fall during the initial Covid shock, followed by a near-tripling of the share price by June 2021. Then it fell another 80% by October 2022 as it grappled with high debts, a slow recovery in demand and concerns about a recession. Another two years on, it is +235% from that nadir. Not an investment for the faint-hearted!

As for Brexit, probably the less said the better. Whatever certainty might have come from the final agreements, it was, perhaps, overshadowed in terms of its effect upon investors' sentiment towards the UK by the ongoing shenanigans in Downing Street. Even so, there is some evidence of a sterling rally in the first few months of 2021, some of which could be attributable to the lowering of uncertainty.

Is there a similar trade today that could be captured in a few letters? The big issues surrounding us now that have some sort of calendar based schedule are the forthcoming UK Budget (30th October), the US Presidential election (5th November) and China's National People's Congress (NPC - date to be finalised, but soon). I must admit I'm struggling to some up with a catchy combination. BPC?

The first of these should be the least important on the global level, at least as long as we assume that Chancellor Reeves has heeded all the warnings about how the bond market would react to overgenerous unfunded fiscal measures. Even so there remains a lot of uncertainty about how she will try to stimulate more growth in the UK whilst remaining fiscally responsible. There might well have to be some changes to the way certain investments are accounted for, and we have already seen plenty of kite-flying on this subject. For, example, if a physical investment is made, is there a case for it being accounted for as an asset and thus balancing the debt that was taken out to fund it? That would certainly help to contain the published government debt-to-GDP ratio.

In many respects, though, businesses, consumers and savers just want to know where they will stand on taxation levels. There is such a wide range of possibilities being floated at the moment that nobody knows where their finances will be next year. And that sort of uncertainty tends to delay spending and investment decisions. As I have mentioned before, this budget looks set to provide a lot of new business for financial planners. On balance, though, I would judge that getting past it will be positive for investor sentiment.

For all the build up to the US election, there is still a perception that investors have too many other distractions to be able to focus on it fully. That feeling is only heightened by the fact that we are heading into the thick of the third quarter company reporting season. And even though, as I discussed last week, Donald Trump seems to be gaining momentum in the opinion polls and betting markets, the outcome is still not far away from being a coin toss.

Are there any clues that we can take from Trump's win in 2016? The actual result, a Republican sweep of the White House, Senate and Congress, was only a 10% probability ahead of that victory, and so a massive surprise. Even Trump with a split Congress was only 14%, and so a combined 24% chance of becoming President. The firm favourite was Hillary Clinton with a Democrat majority Senate (41%) but not the House. Probably the biggest surprise this year would be a Democrat sweep, and, given the expectations on the House votes, that looks highly improbable. And so, the chances of being blindsided are much lower.

If investors appear to have their eye on one specific risk, it is the bond market. The MOVE Index of implied bond market volatility has been creeping up recently. The last time it was appreciably above the current level (123) was last October, when it reached 140. That saw the 10-year Treasury yield reach a peak of 4.99% vs the current 4.13%. I'm not saying it's going to revisit that level, but, given the concerns about potential future deficit spending and the inflationary implications of imposing tariffs on all and sundry, it's worth keeping an eye on.

We can see that equities rallied nicely following Trump's victory in 2016. The market ended up warming to his reflationary policies and it wasn't until the Federal Reserve set about raising interest rates and then Trump's more aggressive stance on tariffs that things began to unravel in 2018. At least the Fed now seems set on a rate-cutting cycle. But the US fiscal deficit was a lot smaller then, not having had to deal with Covid, and underlying inflation was very weak. We would argue that there have been unfavourable structural shifts in the inflation outlook since then.

Then there is the equity market valuation. On election day 2016, the current price/earnings ratio of the S&P 500 Index was 16.9x, falling to 14.9x on a 12-month forward basis. That's a lot more attractive than the 21x or so on offer today. Also, in November 2016 the S&P 500 was only +3% for the year as opposed to +23% already this year. That doesn't mean one needs to be bearish, and we are quite supportive of some of the reasoning why US equities trade on a higher average multiple today, bolstered as they are by hugely profitable and cash-generative global technology leaders. And we are still, to some degree, pricing out that recession that didn't come. But it might be sensible to repress some of the more gung-ho bullish expectations.

As for China, we remain in some sort of limbo, awaiting more concrete details of the fiscal element of their recently announced stimulus packages. The immediate equity rally has stalled and some people are getting impatient. But there are certain protocols that the Chinese follow, and that means that some of the details will not be available before they are approved by the NPC, probably later this month or in early November. They might possibly wait until they know the result of the US election, given the implications for trade owing to the potential for 60% tariffs on all exports to the US (not to mention other tariffs on goods being routed via third countries such as Mexico). However, I do think that the government has found its pain point and signaled a change in its attitude that would justify not betting against the market currently.

Unfortunately, then, it doesn't seem as though there will be anything as clear cut as the "BVB" trade this year. Certainly nothing as liberating as the vaccine news (for which we should really be grateful!). Politics look to continue to be messy, and we can't even guarantee an immediate result from the US election owing to the close nature of the contest and the possibility of recounts and rejection of the outcome. Whatever happens, though, there is some compelling viewing for us in the weeks ahead.

Economic Commentary

FTSE 100 weekly winners

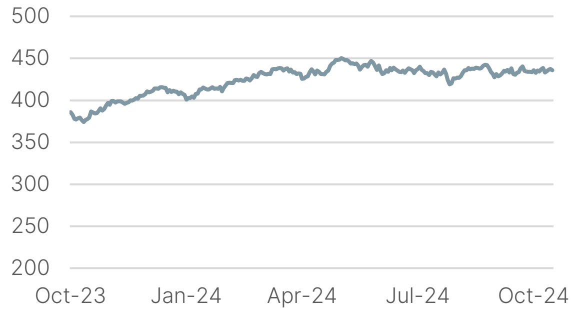
St. James's Place Plc	14.7%
Abrdn plc	9.8%
International Consolidated Airlines Group SA	7.4%
Severn Trent Plc	7.0%
Whitbread PLC	6.4%
Fresnillo PLC	6.0%
Barratt Redrow plc	5.8%

FTSE 100 weekly losers

Just Eat Takeaway.com N.V.	-13.9%
Mondi plc	-12.6%
Croda International Plc	-7.5%
Ocado Group PLC	-7.0%
Entain PLC	-5.2%
Antofagasta plc	-4.6%
DS Smith Plc	-4.5%

FTSE 100 index, past 12 months

EuroStoxx 600 index, past 12 months



S&P 500 index, past 12 months

All data shown in GBP.

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