Weekly Digest
3 September 2018
The weekly insight into world stock markets

Investec Wealth & Investment

Back To School

With the sun beaming downside outside, it's probably somewhat premature to start the countdown to Christmas, but here we are at the beginning of what is traditionally known as the Winter Term. At school we were given a calendar of events at the beginning of every term, and the financial market equivalent today would no doubt focus on potentially negative events, such is the mindset of investors. As I have noted on several occasions in the past, since the Great Financial Crisis the market has consistently been looking out for the next banana skins while heading inexorably upwards when they are avoided (if they even existed in the first place). That doesn't feel as though it is going to change soon. Important diary dates will include: the US Federal Reserve meetings for which further interest rate rises are expected (26th September and 19th December); the new Italian government's first budget (a draft must be submitted to the European Commission on October 15th); and US mid-term elections (6th November). Less defined in terms of firm dates, but with at least as much capacity to upset markets, will be the ongoing Brexit negotiations as well as trade talks involving the US and a number of counterparties.

In my last piece I looked forward to the record being broken for the longest US stock market bull market in history, and, by general consent, this duly occurred on August 22nd. Contrarians (and worriers) believe that this heralds an imminent collapse, but there seems to be little predictive power merely in the number of days any market-related phenomenon has persisted, certainly on a short-term basis. Indeed, technical analysts would be reminding us that momentum is a powerful force – "the trend is your friend". And for all the talk of overvalued markets, US equities have been supported by phenomenal earnings growth, currently running at around 25% year-on-year. Yes, much of this is a one-off effect driven by tax cuts, but those tax cuts are not going to be reversed any time soon. The forward Price/Earnings ratio for the S&P 500 index is pretty much where it was in early 2015: earnings forecasts have risen 39% (according to Bloomberg), while the index is up 43%. Earnings are ultimately the key driver for equities, and (tax changes notwithstanding) tend to be most affected by the underlying economy. No doubt that is why every economist and his dog are on high alert for the next US recession, but, given the latest annualised growth rate of over 4%, there seems minimal probability of one developing soon.

Another point to make about equities is that, in aggregate, they are destined to continue to make positive returns over the long-term because they reflect real underlying growth in the economy. The better companies will reinvest profits at an incremental rate of return. This point was made by none other than Warren Buffett in an interview last week on his 88th birthday, and we are very much with him when it comes to endorsing investment in equities as a key element of a long-term investment plan.
Another couple of things have caught my eye, both of which might interest contrarians. The first is the abject performance of Emerging Market (and to a lesser extent European) stocks relative to US peers. Analysts at JP Morgan pointed out that the relative momentum between these groups is at its most divergent since their records for this sort of thing began in the 1990s. By inference, what will happen next is either that US shares will succumb to a weaker global environment or that EM and European shares will catch a bid as investors realise that these economies and markets are not going to submerge. Having said that, EM equities are nowhere near offering the sort of relative value that they did in 1997/98, but, there again, we have not witnessed a broad crisis. No doubt times are tough in Venezuela and Argentina and deteriorating in Turkey, but none of this should have come as a great surprise to reasonably well informed investors or businesses cognisant of the existing weaknesses of these countries. We will have to keep an eye on trade negotiations as well as the effect of Federal Reserve interest rate policy on the dollar denominated liabilities of EM countries and companies, but are inclined to the view that an opportunity is being presented to increase exposure for the long-term.

A less well-known hot-bed of investment opinion is the (football) Premier League, but last week the Financial Times reported that an increasing number of its overseas players are no longer happy being paid in devaluing pounds and want to hedge wages into their home currencies (the views of Argentinian and Turkish players were not made public). This recalls the occasion in 2007 when supermodel Gisele Bündchen chose to be paid in euros rather than devaluing dollars. She didn't quite call the turn, but would certainly have been better off not bothering for most of the time since. Our view is that the pound remains vulnerable, especially in the short term, to the "harder" iterations of Brexit, but the majority of pundits now view sterling as being at least marginally cheap on traditional measures such as Purchasing Power Parity and the Real Effective Exchange Rate relative to history. Obviously calculations can change dependent upon the evolving terms of trade that the UK will have post-Brexit, and that outlook is as clear as mud. This uncertainty underpins our approach of investing in a broad range of global assets, offering clients a diversification of risk that can protect portfolios from extreme volatility during stressful periods.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Whitbread	15%
United Utilities Group	3.5%
Severn Trent	3.4%
NMC Health	2.9%
Bunzl	2.9%
London Stock Exchange Group	2.7%
Micro Focus International	1.2%

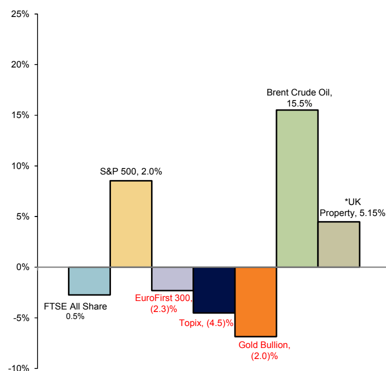
Source: FactSet

FTSE 100 Weekly Losers

Sage Group	-7.5%
Vodafone Group	-6.2%
Fresnillo	-5.3%
British American Tobacco	-4.8%
Barclays	-4.3%
Smurfit Kappa Group	-4.3%
Royal Mail	-3.6%

Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months

Source: FactSet

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