Weekly Digest

23 July 2018

Investec Wealth & Investment

The weekly insight into world stock markets

Heading Off…

When I worked in the US back in the 1980s, I was introduced to the concept of the “Acapulco Spread”. This involved putting on a very large directional trade before flying to Acapulco for the weekend. If the trade worked out, you came home. If not, you stayed in Acapulco, possibly for a very long time! All of which introduces the fact that I am off on my summer holidays this week (but won’t be leaving any speculative trades behind!). I leave you in the very capable hands of some of my colleagues who have volunteered to offer their views in my absence.

And I will be back, if for no other reason than to celebrate that longest bull market in the history of the US stock market (as long as I haven’t jinxed it now). The S&P 500 will hit this landmark on August 22nd. No doubt a lot will be written about it, and almost certainly much of what is written will be warning that a catastrophic crash is inevitable. We have by no means been cheerleaders for the recent gains made by US equities, but things do need to be put into perspective. First of all this has been a very “shallow” bull market, so even if it’s lasted a long time the annual returns have not been spectacular. Since World War II, the average annualised return from a US bull market has been 19.2%. The punchiest gains were 26.9% from 1982-87, the first leg of perhaps the greatest secular bull market ever. The most anaemic were 14.1% from 1974-80, which was a period of relief during a long, trying secular bear market. The current bull market has churned out lower-than-average annual returns of 16%, but remember also that the starting point was the aftermath of the worst financial crisis in living memory.

That’s not to say that there aren’t things to worry about. The end of August also heralds the end of the consultation period on the next round of tariffs that Donald Trump has threatened to impose on another $200 billion of imports from China. The escalation of trade wars is probably the single largest threat to financial markets at the moment because it has the potential to create any number of unintended (negative) consequences and collateral damage. As I have written about previously, the headlong depreciation of the Chinese yuan against the dollar is all very much part of this story. The Chinese government continues to make statements to the effect that it wants to avoid an escalation, but there is more than a sneaking suspicion that it is happy to see the yuan depreciate. But at least it’s a steady slide rather than a sharp drop. What is not clear yet is whether there is a wholesale flight of capital from China similar to what we experienced between mid-2014 and early 2016, when the People’s Bank of China burned through a trillion dollars’ worth of foreign exchange reserves in an attempt to stabilise the situation. We might get a better idea in a couple of weeks’ time when the monthly data is released. The reserves have hardly budged over the last couple of years. That could be a key moment for markets.

The parallel here, of course, is that a mere 3% yuan “devaluation” in August 2015 triggered a sharp correction for global risk assets, and there is no shortage of predictions of a re-run. But I would argue that there was already something else bothering markets before that and the Chinese currency move was the final straw. The “canary in the coalmine” in 2015 was the US High Yield bond market. Mainly thanks to stress building in the Energy sector (thanks to the Saudis’ desire to push down the oil price with the barely disguised intention of putting US shale producers out of business), the yield spread for High Yield over US Treasuries had exploded from 460 basis points at the beginning of June to 575 points by the middle of August. A rising High Yield spread is a pretty reliable precursor of trouble brewing for equities. Right now the spread is 368 basis points, slightly lower than the 373 at the start of 2018, and quite a bit lower than the 390 at the start of July. I would be a lot more concerned if there were greater signs of stress in this indicator. Certainly one to keep an eye on.

Finally from me, a bit of reminiscence and social commentary. I have loved watching the Open championship (golf!) from Carnoustie, a course I played several times when touring up there in the ‘90s. I was reminded by a fellow tourist that in 1993 we paid the princely sum of £43 for a combined green fee on the Championship and Burnside courses (that’s £87 allowing for inflation). Today the same ticket costs £250! Golf club membership is collapsing across Scotland, exacerbated by rising membership fees owing to fewer members to cover the costs. This used to be a game for the many, not the few. I see also that the R&A, which organises The Open, has stopped spectators from leaving the course during the day and getting free readmission, meaning that the locals have complained of “ghost town” conditions despite a quarter of a million people visiting! Sometimes “big business” looks like its own worst enemy, and one is hardly surprised by the current populist trends.

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FTSE 100 Weekly Winners

Ocado Group	5.2%
Intertek Group	4.0%
Unilever	3.9%
Prudential	3.7%
DS Smith	3.3%
Hargreaves Lansdown	3.3%
Barratt Developments	2.9%

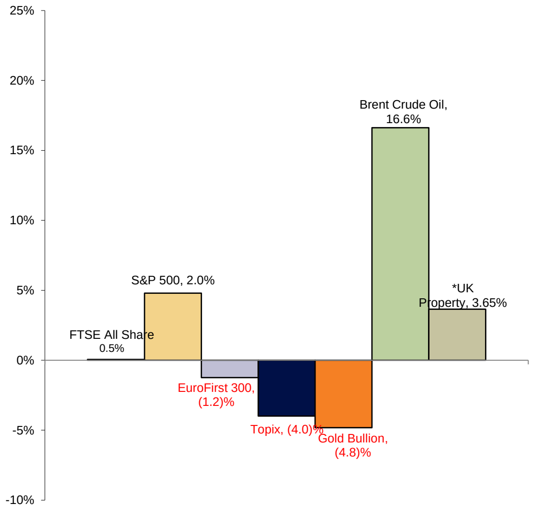
Source: FactSet

FTSE 100 Weekly Losers

WPP	-7.2%
Smiths Group	-7.2%
Centrica	-4.7%
Royal Mail	-4.5%
Anglo American	-3.5%
Rentokil Initial	-3.0%
British Land Company	-2.7%

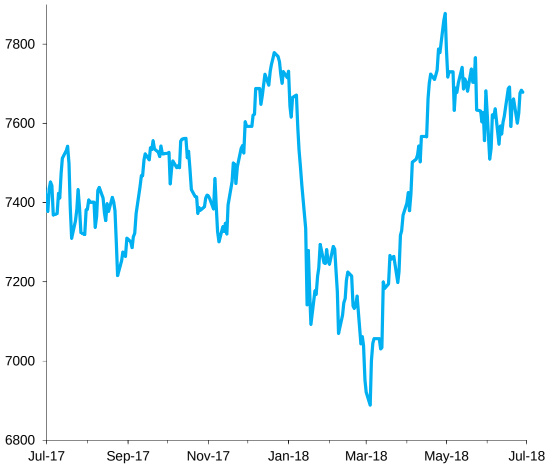
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet

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