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Wealth & Investment

The weekly insight into world stock markets

Praet à Taper

Politicians continue to hog the headlines, and the headlines coming out of the G7 meeting over the weekend almost defy analysis. Playground-style name-calling seems to be the order of the day now, made worse by the fact that much of it is delivered by tweet. I seem to remember the words “Come here and say that to my face!” being aimed at me if I ever stooped to such cowardly tactics in school – well, it was more like hurling an insult from behind a safely secured door or window back then. The optimistic take on the current situation is that this is all just posturing and playing to the voter gallery, which could be why markets have given up reacting to the noise. A more pessimistic view is that there will be a gradual escalation of retaliatory tariffs until the world inadvertently finds itself in the middle of a full scale trade war. On the basis that (relatively) free-flowing trade has been the status quo, overall conditions can really only deteriorate from here.

Much the same can be said for the forthcoming Trump/Kim summit. The United States and North Korea have theoretically been at war since 1950, although there has been a ceasefire in operation since 1953. During this time Japan recovered to become for a while the second largest economy on the planet while South Korea became a leading industrial nation and a centre for technological innovation. Indeed the whole of South East Asia has prospered despite the ever-present threat of North Korean hostilities. It’s a bit like living with a wasps’ nest in the attic. Everyone goes about their business while keeping a respectful distance. Mr Trump could be the man from the council who is going to extinguish the wasp threat for good, in which case life will go on much as before; or he could poke his big stick into the nest and make them mad as hell, in which case everyone has to run for cover and lock all the doors and windows. There are only two potential winners in all of this: Trump’s ego and the people of North Korea, neither of which do I feel are going to have much influence on our investment opinions – actually a puffed up Nobel Peace Prize-winning Trump would constitute a greater risk.
The real action for investors to focus on this week in going to be in the much more mundane setting of central bank offices, with the rate-setters of the US, Europe and Japan all meeting to discuss policy. The pace of monetary tightening could well be the key driver of investment returns for the foreseeable future. Nobody should need reminding that Quantitative Easing and Zero (even negative) Interest Rate Policy have played a big part in getting us to where we are today. Excess liquidity created by central banks has found its way into every corner of the financial markets, low interest rates have allowed companies and governments to finance themselves cheaply, while normally conservative investors have been compelled to buy riskier assets to generate income. This policy was launched to avert a potential melt-down of the financial system in 2009, and then to defend the euro against collapse in 2012. Recent gyrations on account of Italian politics notwithstanding, the case for “emergency” policy settings is hard to make now, so liquidity is gently being withheld and interest rates have started to trend upwards.

The US, as often is the case, is at the head of the pack. It stopped buying bonds as far back as October 2014, and raised interest rates for the first time in December 2015. There have been five more quarter-point rises, and the market very much expects another one on Wednesday. Then it’s just a question of whether it’s another two or only one more over the rest of 2018. At the same time the Fed has started running down its balance sheet (at the rate of $30 billion a month currently, rising to $50 billion in the fourth quarter of 2018) in a controlled and clearly communicated manner. Thus there should be no surprises – indeed, if anything the Fed has the capacity to hold back sales if it sees any signs of stress. It was interesting that last week the governor of India’s central bank suggested that the Fed might want to take the increasing levels of US government debt issuance into account when making its decisions. That’s another sign that there is some stress building in emerging markets, a subject that I discussed three weeks ago. Tighter monetary policy has a history of weeding out the weakest credits, and Turkey, Argentina and Venezuela, for example, have already suffered.
QE is credited with having boosted equity valuations, and it’s interesting to note that the 12-month forward PE on the S&P 500 is currently 17.4x, which is almost exactly what it was at the end of 2014, when the Fed stopped buying assets (Bloomberg data). Since then the ECB and the BoJ have taken up the running, which has provided further support, but we have been mindful for a while that projections suggest that global central bank balance sheets will begin to shrink in aggregate around the beginning of 2019. Key to this is the timing of the ECB’s tapering plan, which is why a comment last week from the ECB’s Chief Economist Peter Praet that the council must make an assessment this week “on whether the progress so far has been sufficient to warrant a gradual unwinding of our net asset purchases” induced a wobble in both equity and bond markets. Incidentally, an anagram of Praet is “taper”. Is that a sign? Forget Singapore. Riga is where it’s all happening.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Barratt Developments	4.8%
Next	4.6%
Informa	4.3%
Intertek Group	3.9%
Halma	3.9%
Associated British Foods	3.8%
Johnson Matthey	3.6%

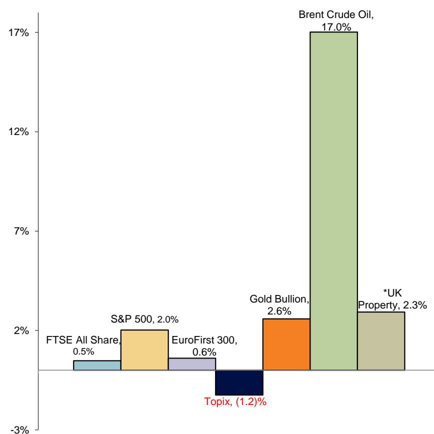
Source: FactSet

FTSE 100 Weekly Losers

Mediclinic International	-9.3%
Fresnillo	-7.1%
Old Mutual	-6.8%
Carnival	-6.0%
Paddy Power Betfair	-5.0%
Imperial Brands	-4.7%
Smurfit Kappa Group	-4.5%

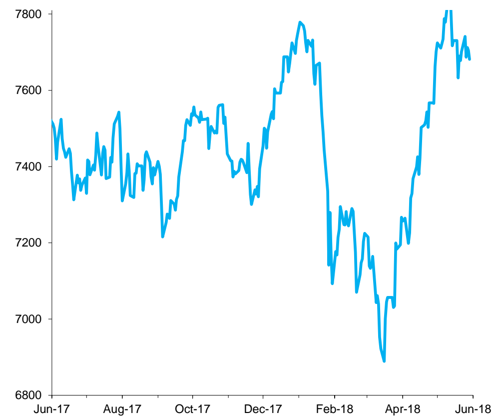
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet

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