Taking Stock

An investor lucky enough to be cut off from financial news so far this year might inspect their portfolio today and wonder what all the fuss has been about. The MSCI All Countries World Index (in US dollars) is up almost 2% since the end of last year. Of course, those of us who have lived every minute of it will know that it was up more than 7% at its peak towards the end of January, and then fell 9% in little more than a week before recovering. Sterling based investors have struggled a bit more thanks to the pound's 3.6% rise against the dollar, although it should be noted that this is more a function of dollar weakness than sterling strength.

Thanks in part to this currency headwind, the UK's FTSE 100 Index is notable for being this year's worst-performing main stock market index when measured in local currency terms, having fallen 5.2% (China's Shenzen Composite Index is down 8.43%, but is a more regional index stuffed with speculative technology stocks). Big steady overseas earners such as BAT, Royal Dutch Shell, BP, Diageo and Unilever dominate contributions to the near 400 points that the FTSE 100 has lost this year. But it must be said that there also a few names on the list of poor performers where the losses have been more to do with the market's reaction to company-specific news, and these include Vodafone, Shire and Imperial Brands.

Interestingly, several companies that generate a small part (or even none) of their revenue in the UK are amongst the biggest positive contributors to the index's performance. Within the Top 10 are Anglo American, Rio Tinto, WPP, Standard Chartered and BHP Billiton. The strong nature of global growth is seen as supportive for mining companies, and the potential for higher interest rates is positive for banks' earnings.

These large companies tend to make regular appearances in the big contributors to index movements owing to their high share of market capitalisation, so it's also useful to look at the best and worst performers regardless of size. There is no consistent theme apparent amongst the winners, with GKN topping the list following the bid approach from Melrose. Companies such as EasyJet and Just Eat have benefitted from strong trading updates. Next defied the more gloomy prognostications for all things retail. Old Mutual's South African business became more valuable once Jacob Zuma had resigned as president.

At the other end of the table there are several companies that have encountered specific business difficulties, and these include Standard Life Aberdeen, BT Group and Micro Focus. However, there is a more dominant macro theme at play amongst the losers, and that is the threat from higher interest rates and bond yields. Housebuilder Barratt Developments, real estate company Hammerson, and utilities Severn Trent and United Utilities are all in the bottom ten.

As a firm we are committed to active stock-picking and asset allocation. Yes, there are periods when index investing will deliver easier, more consistent returns, but often at the expense of investors herding into popular shares, creating greater risk for the future. Whether it be picking individual securities or in our choice of third party fund managers, we definitely believe it is worthwhile making the effort, and, indeed, taking the risk to enhance longer-term returns for clients.

Although equities tend to dominate the headlines, developments in bond markets often lead the performance of other asset classes. Bond markets have suffered more sustained losses this year. The US 10-year Treasury yield has risen from 2.4% to 2.87%, which will have delivered a near 5% capital loss to holders. The UK 10-year Gilt yield has also risen sharply, from 1.19% to 1.6%. However, it is notable that the FTSE Actuaries UK Conventional Gilt Total Return Index has "only" lost 2.5% so far in 2018, despite having an average duration of about 11 ½ years. The rise in yields has been much greater in the 5-10 year maturity range, with, for example, the 30-year Gilt yield rising only 20 basis points. The longer end of the yield curve tends to be supported by persistent regulator-driven demand from pension funds and insurance companies, but could also reflect the fact that the current inflation scare is more a short-term cyclical fear than a long-term structural one.

The market-derived expectation for UK inflation in ten years' time has risen only marginally from 3.05% to 3.15% this year. Even at its lowest point last year in June it was still 2.93%. The big jump in inflation expectations came after the Brexit referendum, when the 10-year breakeven rate jumped from 2.3% to 3.1%. This was mainly down to the fall in the pound, but also reflected more structural Brexit fears, such as a tighter jobs market in the absence of free movement of labour from the Continent, as well as more costs associated with cross-border trade. Inflation expectations are broadly unchanged since the summer of 2016. The picture in the US is different. There has been a greater acceleration of inflation expectations since mid-2017, with the 10-year breakeven rate rising from below 1.4% last June to 2.1% now. Some of that is down to the dollar's reversal, some to the washing out of lower oil prices and mobile phone contract offers, but there is a much greater sense of late-cycle boom conditions than elsewhere, amplified by President Trump's big deficit-funded tax give-away.

It is very much the sentiment in US bond markets, and thus the focus on inflation and deficit-spending, that is setting the tone for all other markets right now. Next week, barring any other excitement developing, I will delve deeper into the inflation debate. Finally, Argentina and Yugoslavia are the only teams other than the USA and Soviet Union to win the Olympic men's basketball gold medal in the last 19 games. This week, in which English city is the Belgrade Theatre?

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FTSE 100 Weekly Winners

Evraz	18.5%
WPP	14.8%
Fresnillo	13.1%
Coca-Cola HBC AG	11.0%
Just Eat	10.3%
NMC Health	10.1%
Smurfit Kappa Group	9.4%

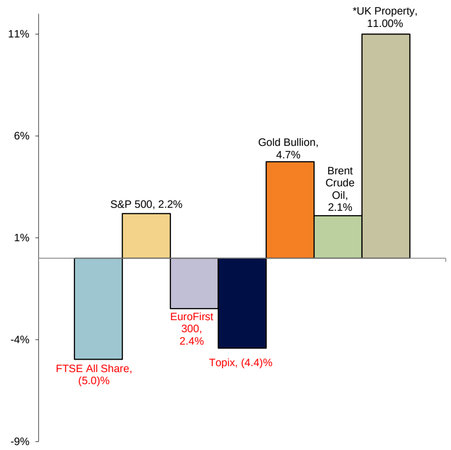
Source: FactSet

FTSE 100 Weekly Losers

Standard Life Aberdeen	5.5%
Severn Trent	-4.5%
United Utilities Group	-3.5%
TUI AG	-2.0%
BT Group	-1.1%
Hammerson	-0.7%
AstraZeneca	-0.6%

Source: FactSet

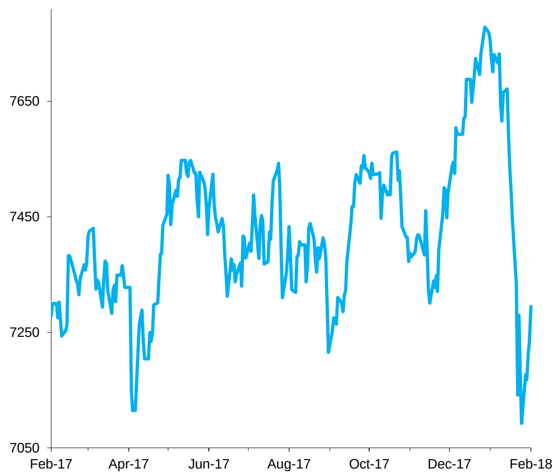
Year to Date Market Performance



*Lagged to latest UK IPD Total Return All Property Index (Dec 2017)

Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet

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