Weekly Digest
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Investec
Wealth & Investment

The weekly insight into world stock markets

Half-Time Report

The apparent increasing speed of the passage of time as one ages is a well-documented phenomenon, but I am still surprised by how quickly we have reached this point again. It doesn't seem five minutes since John Haynes and I were covering the length and breadth of the country with our Vision presentations for 2018, but already it's time to report on whether or not we need to wear corrective lenses. For all the huffing and puffing and political shenanigans, most equity and bond indices are not far away from where they were at the start of the year, which means that it's been a hard environment in which to generate decent returns in a balanced portfolio. For example, the FTSE Private Client Investor Balanced Index managed a gain of just 0.8% in the first six months of the year.

Our headline view on growth at the start of the year was that it would continue at a decent pace, but while the consensus of economists now forecasts global growth of 3.8% this year (Bloomberg data), up from 3.7% in January, the current mood feels much more cautious. The good news is that the US powers on, with tax cuts and increased public spending driving this year's growth forecast up from 2.55% to 2.9%. The bad news is that we have seen a rolling over of expectations in Europe, China and (especially) wider Emerging Markets, thus throwing out of balance the much-vaunted "synchronised global recovery". This is not necessarily a disaster, as we believe that there are temporary forces at work: Europe has suffered bad weather and a nasty flu season on top the restraining effects of a 20% appreciation of the euro against the dollar in 2017; China has been deliberately letting some air out of its own tyres; Emerging Markets in general have been impacted by the rise of the dollar. We do not believe that any of these problems are insurmountable or that they portend a severe downturn or crisis. So, all other things being equal, it would be "steady as she goes".

Unfortunately, all other things are far from equal, and it is politics that once again causes the problems. Uppermost of concern is the escalating trade war initiated by Donald Trump, first squarely targeting China, but now encompassing pretty much all America's trading partners, with a particular emphasis on Germany's car manufacturers. As I have commented before, viewing trade wars through the lens of Game Theory suggests that a rational diplomatic solution will be reached as both sides have too much to lose in the event of all-out conflict – as appears to be the case in, for example, North Korea and Italian politics for now. But it's not clear that all parties are rational in this trade war "game", and that ideologies and/or the influence of the ballot box (US mid-term elections) have a bigger say. We can at least congratulate ourselves on predicting that politics would continue to be a source of volatility, but making precise predictions remains as difficult as ever. In the last few years markets have consistently priced in political risk, and then when it didn't materialise have bounded forward as underlying corporate performance has been strong. If Mr Trump suddenly wakes up and sees the error of his ways the same will happen again, but it's certainly not something we are willing to bet on.

Central bank policy was also high on our agenda, and this has been easier to predict, with the US Federal Reserve plodding along its guided path to higher interest rates, while the European Central Bank has set out its plan for ending Quantitative Easing with a view to starting to raise interest rates later in 2019. We continue to see the monetary tailwinds that have supported financial markets continue to weaken, putting more of the onus for returns on earnings and dividend growth.

In terms of asset allocation, our big win was to predict a 10% fall in equity markets, although, to be honest, we didn't necessarily forecast it to happen while we were still doing the rounds. But all the expected reasons came together: an inflation scare; threat of more aggressive monetary policy; rising bond yields; snap back from an unusually long period of low volatility. We didn't expect it to develop into a much deeper bear market, and we were right there too. Despite that scare, our preference for equities over bonds has also paid off, although it must be said that there is has been very little to choose between them so far this year. The MSCI All-Countries World Index has eked out a total return of -0.16% in dollars (+2.34% in pounds), while the Barclays Global Aggregate Total Return Bond Index is -1.46% (+1.01% in sterling). Not a great environment for asset allocators to produce returns (either absolute or relative), although that does have its own silver lining. We came into the year carrying Overweight calls on Europe (ex-UK), Japan and Emerging Markets, and they have all struggled, not least thanks to the trade war worries. However, the underperformance has been relatively muted, so no great harm has been done.

Overall the headmaster's comment on the half time report would definitely conclude that we could have done better, but we would also point out that markets have not been in a giving mood this year. As I wrote last week, we retain a marginally cautious tilt overall and we will desist from taking really big bets until some of the current uncertainty is resolved, in whichever direction that turns out to be.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Rolls-Royce Holdings	5.1%
Shire	4.9%
BAE Systems	3.5%
Imperial Brands	3.4%
Sky	3.3%
Severn Trent	2.6%
BHP Billiton	2.4%

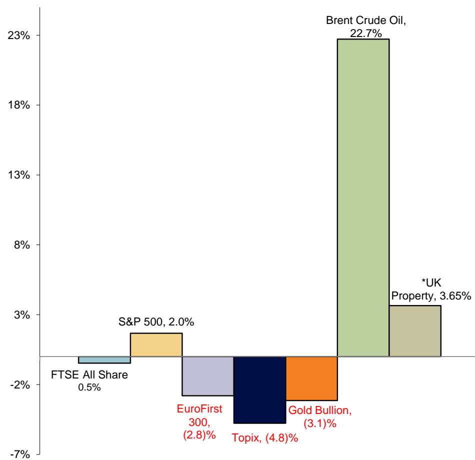
Source: FactSet

FTSE 100 Weekly Losers

International Consolidated Airlines	-8.6%
Carnival	-8.3%
easyJet	-6.6%
Glencore	-6.5%
Just Eat	-5.5%
Standard Life Aberdeen	-5.3%
Prudential	-4.4%

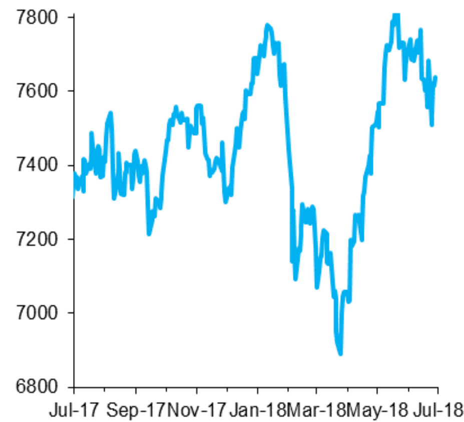
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet

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