Weekly Digest
4 December 2017

Investec
Wealth & Investment

The weekly insight into world stock markets

Updating Brexit and Bitcoin

Time to update our views on two of the biggest headline grabbers of the day. First, Brexit. I woke up this morning to what sounded like an optimistic outlook on Mrs May's latest visit to Brussels, but the mood had already soured by the time I reached my desk. While there seems to have been progress on the "divorce bill" and citizens' rights and a glimmer of hope on the Irish border issue, the role of the European Court of Justice is again cited as a roadblock. Investors and traders are expressing their (dis)approval of the possible outcomes in the foreign exchange market, with sterling bouncing around on every scrap of news. That then transmits itself to the equity market, with the rule of thumb being "sterling up, FTSE 100 down" and vice versa, owing to the high overseas content of earnings.

Since the pound hit a trade-weighted low at the end of August it has risen 5.6% (although remains 10.5% below its pre-referendum level), which means that UK shares have been a distinct laggard in local currency terms. Since August 29th, the FTSE 100 has generated a total return of 0.24%, whereas the S&P 500 has gained 8.58%, while the EuroStoxx 600 is up 4.6%, with global equities rising 4.6%. It all looks different on a constant currency basis. Measured in sterling, the S&P 500 is up a more pedestrian 3.89%, while the EuroStoxx 600 is actually down 0.83% (all data at 9am Monday).

It remains our policy not to hedge overseas equity holdings unless we see a very specific reason for weakness in the local currency. The natural hedge between currency and equity markets, due to the overseas earnings, means that a lot of the moves "come out in the wash", as it were. Putting on a hedge, although it sounds like a form of insurance, actually increases the underlying volatility of the position, so is akin to raising the risk profile of the portfolio, something we are not currently minded to do.

The pound itself remains under several influences. Valuation measures are supportive. The bulk of economists and investment banks judge it to be trading somewhere between 5% and 15% below fair value, based on measures such as the Real Effective Exchange Rate, Purchasing Power Parity and also the Economist's Big Mac Index. Central bank policy is only marginally supportive. The Bank of England raised rates a month ago, although the accompanying statement did not suggest another move soon, and markets don't see the next rise until summer 2018 at the earliest. Traders have, until recently, been more heavily positioned for further falls, so the recent rally has been exacerbated by a short squeeze. Trade and investment flows are less helpful. The current account balance remains negative, investment into the UK has suffered from Brexit uncertainty, and global investors have been shying away from UK assets. In the background there is also the threat of another election and a Labour government, which is almost universally viewed as a negative development for UK financial assets – think higher taxes and punitive regulation of financial services. Indeed, the latter is why we recently recommended increasing holdings of global sovereign bonds.

Even as I am writing this article, the pound has jumped the best part of a cent against both the dollar and the euro thanks to some more constructive comments from a member of the European Parliament, Guy Verhofstadt, underlining the fact that it is impossible to trade every twist and turn in this saga. And there is still a long way to go. In "X-Factor" terminology I would say that we are currently somewhere between "Bootcamp" and "Judges' Houses", and so there is still a whole series of live shows to come. Of course, the big difference is that we, the audience, are not going to be able to vote. We remain of the opinion that whatever our trading relationship with Europe turns out to be, it CANNOT be any better than it is now. That has already been recognized by markets, if not by the more committed Brexiteers, but even if this all just turns out to have been a very strange dream, investors' attention has been clearly drawn towards the UK's structural problems (trade deficit, poor productivity, inequality, etc), so it is very hard to see a return to the status quo ante.

I last wrote on Bitcoin on September 18th (Desperately Seeking Satoshi Nakamoto), when the price closed at \$4,006. As I write it is just over \$11,300. Obviously, with the benefit of hindsight, I should have recommended aggressive purchases, but there is no feeling of regret. Any basis of valuation for the cryptocurrency remains elusive, with extrapolation of the current trend appearing to be the main driver of the price. There have been two key developments since September. One was the cancellation of a possible "fork" (which would have created a new version of Bitcoin), which has cemented Bitcoin's position as the primary vehicle. The other is the announcement by the Chicago Metals Exchange that it will offer Bitcoin futures, thereby validating its existence and potentially creating a more liquid market in which opposing views can be taken.

To us this all continues to bear the hallmarks of speculation, although we have always acknowledged the value of the underlying blockchain distributed ledger technology. Speculate at your leisure – there is no shortage of funds and brokers inviting you to do so – but we cannot consider Bitcoin to be an asset class. All the Bitcoins in the world are worth around £140 billion, so still smaller than either Royal Dutch Shell or HSBC, the largest constituents of the FTSE 100.

Finally, Lancashire Day commemorates the day in 1295 that the county first sent representatives to Parliament. This week, Southampton, Bosham in West Sussex and Gainsborough in Lincolnshire all lay claim to being the site of which 11th century event?

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Mediclinc International	7.3%
ITV	5.7%
EasyJet	4.4%
BT Group	4.3%
Kingfisher	4.1%
Berkeley Group Holdings	3.9%
WPP	3.9%

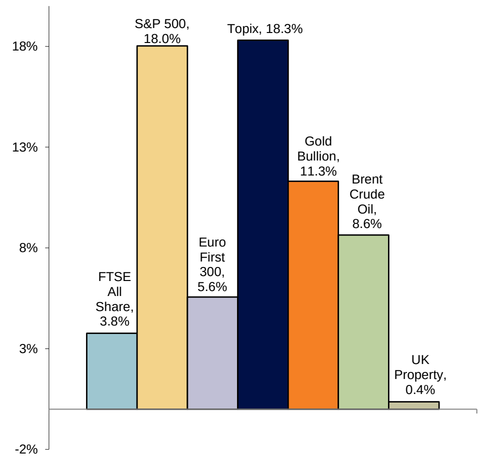
Source: FactSet

FTSE 100 Weekly Losers

Antofagasta	-8.1%
Micro Focus International	-7.8%
Glencore	-6.5%
Associated British Foods	-5.7%
Roll-Royce Holdings	-5.5%
Randgold Resources	-5.4%
Anglo American	-5.2%

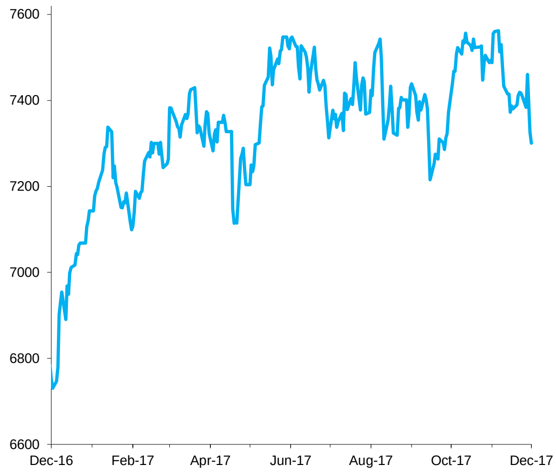
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet

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