Weekly Digest
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The weekly insight into world stock markets

Investec
Wealth & Investment

More Bark Than Bite?

With the first quarter behind us, it's a good time to review what we have learned so far this year. The big thing that has happened is the return of volatility to markets, notably equities. I must admit that we were somewhat premature in predicting this would happen last year, but through 2017 there was a perfect combination of accelerating global growth and tame inflation that kept volatility repressed. Now the inflation cat has at least one paw out of the bag and growth, while still very acceptable, is no longer accelerating (and could be under threat from President Trump's protectionist policies) – and this when global central banks are gradually reducing liquidity.

To put a bit of perspective on the volatility shift, look at this long-term data. The VIX Index, the widely quoted measure of volatility, has been in existence since the early 1990s. For the first twenty-seven odd years of its life it closed below 10 (so indicative of very calm conditions) a grand total of NINE times. In 2017 alone it managed that feat on no fewer than FIFTY-TWO occasions! Following five further sub-10 closes at the beginning of January, we've since been on a rollercoaster that's taken us as high as 50 intra-day, with the 50-day average currently running at 20.1, which is pretty much bang on its lifetime average – just in case there was any doubting the assertion of the Chief Investment Officer of our South African business, Professor Brian Kantor, that VIX is a mean-reverting series! So the first lesson the market seems to have learned is that the days of repressed volatility are behind us, which means choppier markets, but also, more optimistically, more opportunities for active managers.

As I wrote about a couple of weeks ago, President Trump's imposition of tariffs on selected imports has upset markets too. But, as with the North Korean threat last summer, investors have begun to rationalise this behaviour. Kim Jong-un was posturing with no real intent of hitting the launch button; Mr Trump is similarly playing to the populist gallery ahead of autumn's mid-term elections (while also, even more cynically, deflecting interest from his own personal problems). His "Art of the Deal" approach to managing the country seems to involve an outrageous opening bid followed by a more generous settlement. We have seen this in the softening of his position towards Canada in the NAFTA negotiations, for example, as well as in various exemptions on proposed steel tariffs. China is the one country that has yet to be properly appeased, but even then the amounts involved are initially not game-changers in terms of global growth. What would be more worrying is an escalation. Interestingly, after some sharp falls for the US equity market, which remains a key barometer of sentiment for the President, the White House seemed to soften its tone. Equities responded positively, so Mr Trump saw this as allowing him to threaten even more tariffs, resulting in sharp falls again on Friday. Everyone (apart from those in the White House) seems to agree that trade wars are negative, and so (as with North Korea) the consensus in markets is that this will blow over and a face-saving compromise will be reached. A more negative outcome is not priced in. As with many of the threats we have faced in recent years, there is more to lose than to gain here, which will contribute to increased volatility.

The final straw for markets in March was the undermining of confidence in the Technology sector, with several factors contributing. There was the backlash against Facebook for the unauthorised use of private data, Donald Trump's attacks on Amazon (which have a distinctly personal edge to them) and two major setbacks for pioneers of driverless car technology (Uber and Tesla). None of this will stop the relentless march of innovation, and it was a relief to see the float of shares in Spotify, the music streaming business, going smoothly, but there is a sense of growing resistance to the influence of the giants of the sector. Data privacy and fairer tax contributions are high on the agenda. It is hard to see Technology regaining its market-leading status just at the moment.

None of these factors weighed especially heavily on UK-listed companies, and yet the FTSE 100 achieved the ignominious feat of being ranked by Datastream as 67th out of 67 major markets in terms of local currency denominated returns in the first quarter. Matters are slightly better when sterling's creeping recovery is taken into account, but international investors, in particular, seem to have decided that the UK's politics – think Brexit and the threat of a Labour government - make it uninvestable. After making allowances for market composition – the UK is heavy on Resources, but very light on Technology – UK equities could be offering some decent relative value now. By the way, it always pays to look at performance on a "constant currency" basis. The best performing market in local currency terms in the first quarter was Venezuela (+268%)… but it was also the worst performing in constant dollars (-99.9%), because the bolivar lost almost all of its value thanks to rampant inflation of 6,000% and collapsing confidence in the economic management of the country.

Once again the "wall of worry" that markets have climbed for the last few years has accumulated a few new bricks. If nothing comes of the threats, then good global economic growth momentum has the capacity to push equities higher, even if interest rates and bond yields also creep up. But that would seem to involve placing a great degree of trust in Mr Trump to act reasonably. Hmmm…

Finally, the body of water that lies between the southern tip of Argentina and the South Shetland Islands in the Antarctic is The Drake Passage. This week, who commanded the English fleet against the Spanish Armada in 1588?

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FTSE 100 Weekly Winners

Micro Focus International	14.4%
Smurfit Kappa Group	6.1%
Johnson Matthey	5.5%
Imperial Brands	5.3%
Vodafone Group	5.0%
Wm Morrison Supermarkets	5.0%
Persimmon	4.5%

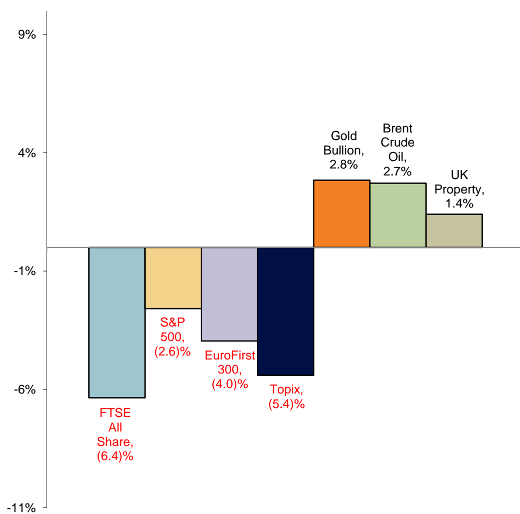
Source: FactSet

FTSE 100 Weekly Losers

Direct Line Insurance Group	-9.0%
GKN	-8.7%
Mediclinic International	-5.3%
Paddy Power Betfair	-4.5%
Randgold Resources Limited	-3.8%
St. James's Place	-3.2%
Anglo American	-2.6%

Source: FactSet

Year to Date Market Performance



*Lagged to latest UK IPD Total Return All Property Index (Feb 2018)

Source: FactSet

FTSE 100 Index, Past 12 Months

Source: FactSet

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