Weekly Digest

9 October 2017

Investec Wealth & Investment

The weekly insight into world stock markets

Crisis? What Crisis?

The cover of Supertramp's 1975 album Crisis? What Crisis? features a man sitting on wasteland basking in the sun with a cocktail against the background of a bleak black and white industrial scene. A few years later, the phrase was attributed (wrongly – yes, "fake news" existed in the 1970s!) to Labour Prime Minister "Sunny Jim" Callaghan, who returned from a conference in the Carribbean to play down the disastrous performance of the UK economy. Such insouciance is deemed to have played a part in the downfall of his government, although one feels that the die was already cast. This episode resonates currently for three reasons.

First, there seems to be a growing nostalgia for 1970s politics in the UK. This has already been seen in the Brexit referendum vote, which has set us on a course for a return to the pre-1973 era, but has accelerated further with the cult leader status achieved by Labour's Jeremy Corbyn, much of whose playbook is right out of that era. He and Shadow Chancellor John McDonnell are recognised as the most left-leaning party leadership in living memory, and the recent party conference did nothing to diminish their status and influence. This worries us as investors and wealth managers. The tone of Labour's business policy is long on intervention, whether to cap prices in certain sectors (which has already forced the Tories to "steal their clothes" on the policy of utility bill price-capping), or to nationalise certain assets. These policies run the risk of distorting markets and also reducing incentives for private sector investors. There is also the threat of a classic "soak the rich" tax regime with a view to redistributing wealth. It is highly probable that unearned income and capital gains would be prime targets.

In the event that Labour were to come to power, these threats would perhaps take some time to be reflected in real economic data, but our fear is that currency traders would recognise the risk much more quickly. Mark Carney, Governor of the Bank of England, has alluded to the fact that the UK is reliant upon "the kindness of strangers", by which he means that our current account deficit has to be funded by capital inflows from overseas investors to stop the pound falling. If those investors sense a change for the worse in their terms of trade (as they did after the Brexit vote), sterling will feel the pressure. And sterling is the only credible safety valve left if the economy gets into trouble: interest rates can't realistically fall further and fiscal policy is constrained by a still-high deficit.

So what are the chances of a Labour government? The Electoral Calculus website has Labour 37 seats short of a majority (and four behind the Conservatives) today. The latest post-conference opinion polls effectively have the two main parties neck-and-neck in the low forties percent of the overall vote. And, of course, an election has to be called first. The bookies' shortest odds (source: oddschecker.com) are still on 2022, so the Conservatives going full term is the favourite. The next shortest odds are on 2018, so the market is saying that either the government will implode soon or weather the storm and last the course. The most probable cause of the government's demise is infighting and a leadership contest. Some see this as a minimal risk, because "turkeys will not vote for Christmas". However, recent events suggest that some Tory turkeys are already making the stuffing.

And these are just domestic issues. North Korea, Catalonia and now Turkey are all in the news for the wrong reasons, and there is wide concern that the de facto leader of the world, Donald Trump, is intent on blowing it up. Yet equity markets sail serenely on, reflecting the "Crisis? What Crisis?" mentality. Warren Buffett has famously advised that investors should ignore politics, which might be easier when you are in his position, but markets are taking that advice. The main reason is that underlying economic performance is as good as it has been since 2010, and we are enjoying the first proper demand and investment-led period of growth since the financial crisis. Indeed, global growth forecasts have been upgraded since the start of the year. Companies, in aggregate, are doing well. Data from Citigroup suggests global earnings growth of 10% in 2017, followed by 9.7% in 2018. Central banks are still printing money. Interest rates, while rising in the US and possibly in the UK, remain negative in real terms. What's not to like?

Well, valuations are not cheap, sovereign bond yields, which determine the prices of riskier assets, are rising, and central banks are slowing down their Quantitative Easing programmes, such that the aggregate global central bank balance sheet might be shrinking by early 2019. These are all reasons why we struggle to be unequivocally positive, while at the same time remaining fully invested. The latter stages of the market cycle are tough to negotiate, as we dance on with an eye on the door.

As for the whole 1970s nostalgia thing, I find it a fascinating psychological phenomenon. I have just spent some time going through childhood photos, and I'm sure this is the lens through which most people view the past. I know that the 1960s and 1970s were pretty grim on any number of levels, but I'm smiling in all the photos, either at Christmas or on the beach, for example, surrounded by loving family. Who wouldn't want to return to that cocoon where we had no responsibilities? But the reality beyond the frame was much harsher. Simpler, maybe. But better?

Finally, the highest mountain in the Southern Hemisphere is Aconcagua. This week, on the original London Underground map, how many stations have apostrophes in their names?

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Anglo American	10.6%
Glencore	7.3%
Rio Tinto	6.8%
Barratt Developments	6.8%
Ferguson	6.2%
Mediclinic International	5.5%
Mondi	5.4%

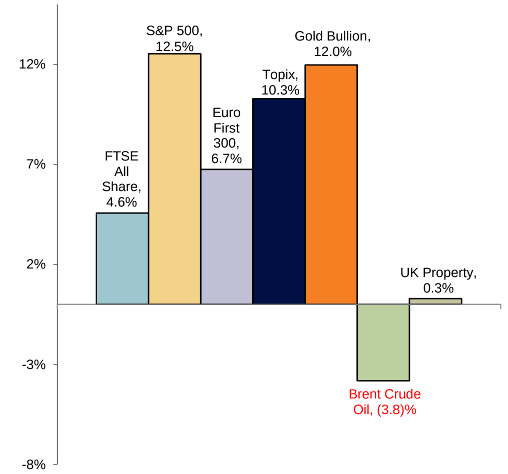
Source: FactSet

FTSE 100 Weekly Losers

Centrica	-6.7%
Aviva	-3.3%
BAE Systems	-2.9%
CRH	-2.2%
SSE	-1.9%
Next	-1.8%
Lloyds Banking Group	-1.7%

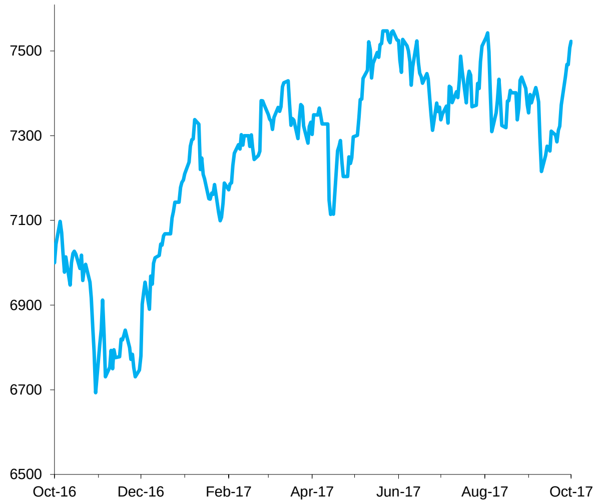
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet

IWI740 v1