

Weekly Digest

27 January 2020

A Weizmann once said

– Richard Stutley, CFA

In 1998, researchers at the Weizmann Institute of Science in Rehovot, Israel, showed that electrons passing through a membrane behave differently when being observed. In a similar way, investors looking for the next bear market are affecting its timing. Bear markets are typically preceded by a period of irrational exuberance, which seems a quantum leap from where the collective mood in markets is today. Traditional indicators such as the shape of the yield curve and the level of equity market valuations have proved ineffective thus far in this latest cycle; little surprise perhaps given the changing rules of the game, with risk free rates (here thinking about US Treasury Inflation Protected Securities) having declined to zero over the past 23 years. Instead of adhering to any single rule of thumb, we have preferred to stay invested on behalf of our investors and broadly diversified, to good effect in 2019.

Investors are happy to own equities at present with the US stock market regularly making new highs through last year, giving the impression that confidence is also high. But this observation ignores the fact that many investors are electing to own shares in high quality, defensive companies, which have therefore performed extremely strongly in the period since the financial crisis. Investing is about being able to distinguish between high and low quality companies, but also understanding what premium to pay for the former and here a huge discrepancy has built up between valuations on the highest and lowest quality names in the market as a result of investor unease.

Another indicator that, at first glance, appears to suggest animal spirits are alive and well in markets is the VIX index of implied volatility, which is currently 24% below its long-term average. A low reading on the VIX is often considered a sign of investor complacency. But underneath the headline index level the skew between expectations for a big upward

move in stock prices versus a big downwards move is very high, suggesting that within the current low volatility regime – attributed to unusually active central bank policy, which has served to put a floor under markets – investors are still nervously looking over their shoulders.

Investors are not the only ones feeling downbeat. Global central banks continue to run extraordinarily loose monetary policy, with good reason on the most part given few signs of inflation in the system, but it is nonetheless surprising to hear the Bank of England talking about a further rate cut as recently as last week. December's election result coincided with, or likely caused, the biggest jump in CEO confidence since before the referendum. With a clear mandate, Brexit uncertainty has been removed and it is instructive at this juncture to cast our mind back to the last time the UK was unencumbered by political (and perhaps self) doubt, pre the referendum in 2016, when it was the second best performing major economy behind the United States.

If investor fears around markets are affecting their reality, it is perhaps unsurprising that the 'most hated bull market in history' is also the longest (at 130 months the current bull market in the S&P 500 has passed the previous longest period of expansion that ran for nearly 10 years from October 1990). There are risks: fear itself can have a huge impact on the global economy and there are also tangible frictions in the form of trade wars, both of which have a crucial bearing on markets. We remain broadly diversified in our portfolios to help navigate short term pullbacks, but we continue to believe it is time in the markets rather than trying to time short term ups and downs, that is key in delivering on our clients' investment outcomes. We pay close attention to the global economy and valuation opportunities, but we try to not let the noise distract us from our clients' needs for long term real returns.

The Marketplace

- Politicians and business leaders met in Davos
- Global markets fall as Coronavirus concerns dominate sentiment
- Brent crude tumbled 6.4% ending the week at \$60.7 a barrel
- Gold rose 0.9% ending the week at \$1571.5 an ounce

Market Focus

US

- Tech sector advances, with notably strong results from Tesla and IBM. A busy week for earnings, with an upcoming Fed policy meeting also on the agenda
- The main US equity index fell by 1.0% last week. The current week begins with a big selloff in US futures
- Treasury index volatility at 8-month lows. The government bond index returned 1.1% as treasury yields hit three-month lows
- In impeachment news, President Trump's former national security adviser John Bolton has indicated that he has evidence the president ordered a freeze of aid to Ukraine if they wouldn't comply with his request to investigate a political rival

Europe

- Continental European equities fell -0.2% last week. All 19 groups which constitute the index were in the red
- Italian government bonds jumped after a big defeat for populist parties in important regional elections. Ten-year yields dropped 16 basis points

- Eurozone composite PMIs surprised to the downside, printing at 50.9 (unchanged from previous month) versus an expected increase to 51.2
- German business leaders expressed pessimism in the recent IFO Institute's survey which fell to 92.9 versus an expected gain (scores above 100). Services and construction showed the poorest prospects

UK

- CBI survey data in the UK showed improvement. Total orders improved 6 points to -22 versus -25 expected. Business optimism increased 67pts to 23 versus -20 expected, a six-year high
- Purchasing activity also improved as the PMI reading for the UK entered expansionary territory, rising to 52.4 versus 50.7 expected
- UK gilts returned 1.3% last week
- The chancellor Sajid Javid indicated that the UK will not seek regulatory alignment with the EU after the Brexit transition period expires at the year end. The UK is set to leave the bloc this Friday

Asia/Rest of The World

- Japanese stocks fell -0.3% last week as news emerged that exports declined 6.3% in December, the 13th consecutive month of decline
- Chinese stocks saw their biggest daily decline in eight months last Thursday, falling -2.8% on the day. This was in response to the coronavirus outbreak which has seen authorities locking down cities and building emergency hospitals to contain the outbreak. The death toll currently stands at 80

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Asset Class/Region	Currency	Currency returns			
		Week ending 24 Jan. 2020	Month to date	YTD 2019	12 months
Developed Market Equities					
United States	USD	-1.0%	2.1%	2.1%	26.5%
United Kingdom	GBP	-1.2%	0.7%	0.7%	15.5%
Continental Europe	EUR	-0.2%	2.2%	2.2%	23.4%
Japan	JPY	-0.3%	0.5%	0.5%	14.3%
Asia Pacific (ex Japan)	USD	-2.4%	1.2%	1.2%	15.6%
Australia	AUD	0.4%	6.1%	6.1%	26.0%
Global	USD	-0.8%	1.6%	1.6%	23.2%
Emerging markets equities					
Emerging Europe	USD	-2.2%	1.7%	1.7%	23.0%
Emerging Asia	USD	-2.7%	0.8%	0.8%	15.5%
Emerging Latin America	USD	-1.1%	-0.7%	-0.7%	3.9%
BRICs	USD	-3.5%	0.3%	0.3%	15.7%
MENA countries	USD	-0.5%	0.8%	0.8%	3.6%
South Africa	USD	-1.9%	-3.1%	-3.1%	-1.0%
India	USD	-1.2%	0.6%	0.6%	13.9%
Global emerging markets	USD	-2.4%	0.5%	0.5%	12.7%
Bonds					
US Treasuries	USD	1.1%	1.6%	1.6%	8.9%
US Treasuries (inflation protected)	USD	0.8%	1.3%	1.3%	9.9%
US Corporate (investment grade)	USD	1.1%	1.8%	1.8%	15.0%
US High Yield	USD	-0.4%	0.3%	0.3%	10.7%
UK Gilts	GBP	1.3%	3.5%	3.5%	10.4%
UK Corporate (investment grade)	GBP	0.8%	2.9%	2.9%	13.0%
Euro Government Bonds	EUR	0.9%	1.2%	1.2%	7.1%
Euro Corporate (investment grade)	EUR	0.5%	0.8%	0.8%	6.5%
Euro High Yield	EUR	-0.1%	0.5%	0.5%	10.1%
Japanese Government	JPY	0.4%	0.1%	0.1%	1.8%
Australian Government	AUD	0.5%	2.0%	2.0%	9.6%
Global Government Bonds	USD	0.9%	0.5%	0.5%	6.1%
Global Bonds	USD	0.6%	0.5%	0.5%	6.9%
Global Convertible Bonds	USD	-0.2%	2.2%	2.2%	11.7%
Emerging Market Bonds	USD	0.1%	1.1%	1.1%	9.4%

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Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	0.7%	2.8%	2.8%	20.1%
Australian Property Securities	AUD	0.9%	7.1%	7.1%	16.8%
Asia Property Securities	USD	-2.6%	-1.9%	-1.9%	6.5%
Global Property Securities	USD	-0.2%	1.3%	1.3%	17.5%
Currencies					
Euro	USD	-0.6%	-1.8%	-1.8%	-2.4%
UK Pound Sterling	USD	0.4%	-1.4%	-1.4%	0.5%
Japanese Yen	USD	0.8%	-0.7%	-0.7%	0.3%
Australian Dollar	USD	-0.8%	-2.8%	-2.8%	-3.7%
South African Rand	USD	0.3%	-3.0%	-3.0%	-4.6%
Swiss Franc	USD	-0.3%	-0.4%	-0.4%	2.7%
Chinese Yuan	USD	-0.5%	0.9%	0.9%	-1.7%
Commodities & Alternatives					
Commodities	USD	-3.7%	-4.3%	-4.3%	0.5%
Agricultural Commodities	USD	-1.5%	-0.8%	-0.8%	-3.0%
Oil	USD	-6.4%	-8.0%	-8.0%	-0.7%
Gold	USD	0.9%	3.2%	3.2%	22.7%
Hedge funds	USD	0.1%	1.0%	1.0%	8.0%

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