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Global Market Strategy – November 2018

- ***Halloween reprieve from October rout***
- ***As in the wake of the financial crisis, only precious metals rally***
- ***Technical heavyweights lose 20-35% from recent highs***

"In case of panic, DO NOTHING!"

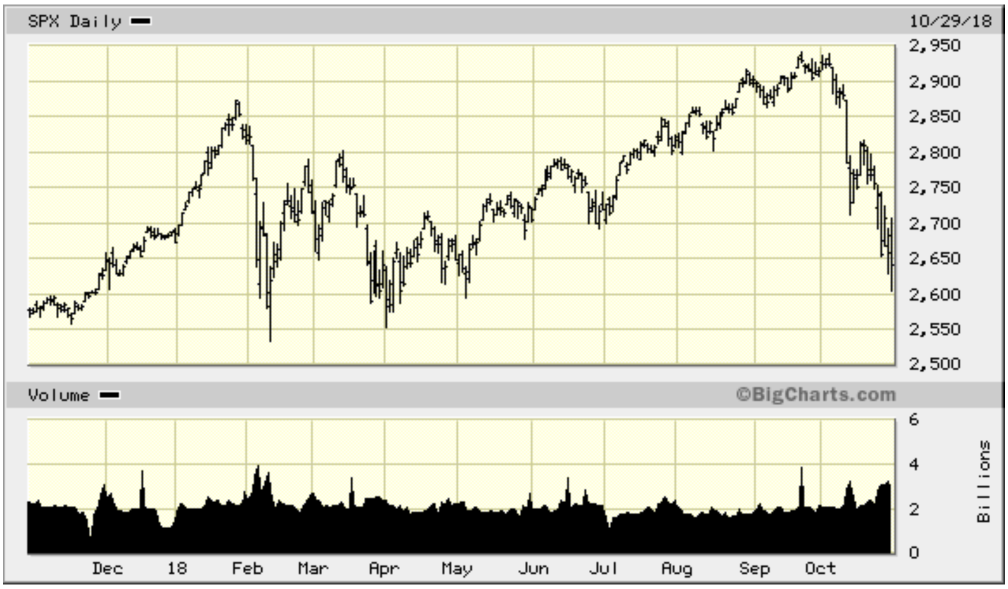
The Federal Reserve's continual talk of constant tightening to more 'normal' rate levels, together with China-US trade tariffs, more Italian financial and political scares, a slowing global economy and Brexit, were all thrown into the cauldron and a scary, spooky October rout of equity valuations was the result.

Tech stocks were savagely hit, with Amazon falling from its $2,000 high only weeks ago, to a level now just above $1,600. Facebook, Netflix and Alphabet (Google) were also shaved harshly, but Apple, up 28% for the year, was merely trimmed, down from a high of $233on October 3rd to $216 at close of business on the 31st.

Thank goodness for more normal market activity, is what many market commentators are saying, though the extent of this pick-up in volatility is not quite what they had in mind one suspects.

Those who suffered most were those selling in the midst of the panic. No one made money by panicing, goes the mantra, and now that the markets are exhibiting signs of being close to a bottom (the Sentiment Index, measuring actions of futures traders, is only 10% bullish - when it falls to single digits, a strong and sustained rally follows 90% of the time), this looks like a time to bottom-fish, although algorithmic trading could still exaggerate nervous sentiment and there could be another leg down of some 5%, but housing and financial stocks look oversold already.

What would be really good for stockholders is if there were some bad economic news in the US, inhibiting the Fed from raising rates again this year. Trump is doing his best to curb Powell's enthusiasm, and from a technical standpoint it is worth noting that the S&P500 has had only two 'up' days in the last 28, something that has happened six times since 1960, so it is quite possible we have indeed experienced the worst of the market correction.



S&P500, 1 year to October 30th (Source: BigCharts.com)

Unsurprisingly, the UK equity market was not exempt from the October sell-off, indeed it fell below its December 31st 1999 then record high of 6930 to 6888 during the third week of the month, again emphasising the folly of buying the index as opposed to sourcing the right individual stocks. Investors are encouraged to diversify, which is fine but random diversification, which is what buying an index is all about, is not so clever; far better to have a concentrated portfolio of studied geographical and / or sector exposure via the best proven fund managers. This includes the balanced-risk multi-asset sector where, with careful research, investors can have access to a concentrated portfolio of mixed assets, including bonds, property, commodities and equity.

The UK equity market is now at a stage where it can be bought with more confidence. Although we have had false dawns before, Brexit negotiations are all but over, and once Britain is out of Europe and is free to fashion its own agreements and policies, a market which has demonstrably been in the slow lane can begin to accelerate, unburdened by bureaucracy, hesitancy and uncertainty.

FTSE100, 1 year to October 31st (Source: BigCharts.com)

It's hard to go anywhere these days without attention being drawn to the increasing demand among investors for **ESG** (Economic Social Governance) exposure within their portfolio. We all want to do our bit, and anyone seeing the BBC programme "Drowning in Plastic" is shockingly aware of the need for society across the world to act now, without delay, in order to protect wildlife for the generations which follow us.

The difficulty investors have is wrestling with their hard-nosed quest not to give up returns for the sake of ESG. It's one thing to pick out a handful of companies which have produced outstanding performance in the ESG space but it's quite another for an IFA to recommend a fund typically containing 80-100 stocks where diversification is at the cost of performance. Would it not be better perhaps to invest with proven fund managers with concentrated portfolios of 30-50 stocks, such as Terry Smith (Fundsmith), Cormac Weldon (Artemis), Gary Robinson (Baillie Gifford), Nick Train (Lindsell Train) and so on and let them source those companies which are not only acutely aware of their impact and responsibility to the environment but also generate healthy returns for investors?

Environmental	Social	Governance
Carbon emissions	Labour management	Corporate governance
Energy efficiency	Diversity and discrimination	Business ethics
Natural resource use	Working conditions	Anti-competitive practices
Hazardous waste management	Employee safety	Corruption and instability
Recycled material use	Product safety	Anti-bribery policy
Clean technology	Fair trade products	Anti-money laundering policy
Green buildings	Advertising ethics	Compensation disclosure
Biodiversity programmes	Human rights policy	Gender diversity of board

BlackRock has its own ideas, and has launched a range of Exchange Traded Funds to meet what it sees as a sector of phenomenal growth.

The world's largest fund custodian by assets under management, predicts that investment in ESG will grow from 3% of total assets now to 28% of total assets by 2028, thus rising from $28 billion to $400 billion. As a consequence of its research, it has launched six new iShares ETFs:

- MSCI World ESG Screened UCITS ETF
- MSCI Japan ESG Screened UCITS ETF
- MSCI Emerging Markets IMI ESG Screened UCITS ETF
- MSCI Europe ESG Screened UCITS ETF
- MSCI EMU ESG Screened UCITS ETF
- MSCI USA ESG Screened UCITS ETF

The UK government is doing its bit and during October invited fund managers to bid to run a new clean tech venture capital fund, christened the Clean Growth Fund.

According to ESG Clarity online magazine, the fund will combine £20 million of government funds with a minimum of £20 million in private funding, for a strategy designed to stimulate growth in the UK clean tech market.

In the Request For Proposals document (attached to this Market Bulletin email) which outlined the requirements for the fund, the government specified that a five year investment period is proposed, with the fund expected to make 20 investments. Later-stage positions are permitted to offset higher risk earlier stage investments. Later stage investments are to include companies with revenues of more than £1 million.

The fund will need to invest into at least five of the following areas:
– Renewable Electricity Generation,
– Renewable Heat Generation,
– Renewable Combined Heat & Power,
– Innovative Energy Networks,
– Energy Storage,
– Low Emission Vehicles & Charging,
– Greenhouse Gas Emission Reduction,
– Domestic Energy Emission Reduction,
– Sustainable Bioenergy Technologies,
– Alternative Fuels

(Source: ESG Clarity online magazine and LastWordMedia.com)

The **UK Budget** just before Halloween turned out to be not so ghouling. The UK continues to be one of the most tax-friendly jurisdictions of the developed world, and announcements that the personal allowance before tax on earnings is to be raised to £12,500, that the 'basic rate' (lowest income tax) band at 20% will be raised to £37,500 so that earnings have to exceed £50,000 before the higher rate of 40% is applied, were warmly received, as was the retention of the £2,000 dividend allowance at nil rate (it was rumoured to be cut completely), the raising of the capital gains exemption to £12,000 (£24,000 per couple), the retention of the personal pension annual savings allowance at £40,000, the ability to relieve tax at the highest rate via pension contribution, the ability to continue to be allowed to retrieve the past 3 years unused annual pension allowances, and the increase in the Lifetime Pension Fund allowance to £1,055,000. Individual Savings Account - 'ISA' (permitting tax free gains and income) annual allowances were retained at £20,000 per individual, and Lifetime ISAs - LISAs - (aimed at nil or basic rate taxpayers savings aged 18-39) offering a 25% government bonus each year, were also retained, albeit at the current level of £4,000 per individual per year. Junior ISAs, aimed at parents saving for children, had their annual limit raised to £4,368 per individual under 18, and for those parents wary of allowing their children access to capital at just 18 years of age, Offshore Single Premium Investment Bonds continue to offer considerable appeal, with a ability to assign segments at the desired time.

Second property ownership continues to tread a trouble path however. Heavier stamp duty for second property purchases, the loss of tax relief on mortgage interest costs, higher capital gains tax levels and exposure to inheritance tax by an illiquid asset, all count against a portfolio of property investment in UK.

Favoured investment plays:

Nil risk:	Cash
Cautious risk:	AAA Corporate bonds
Balanced risk:	Managed / Multi-asset funds
Market risk:	UK, **European equity**
Adventurous risk:	Japan, **Asia, US equity,** UK/European/US mid & smaller company sector
Speculative risk:	**Technology, China, India, Other EM**

Disclosure:

Nicholas Chappell has the following personal investment exposure: Technology (including new energy, all US) 44%, US smaller cos 3%, (Other) US equity 5%, India 3%, China 4%, (Other) Asia 13%, Pharmaceuticals 15%; Global Equity 13%

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