Global Market Strategy – July 2019

The best June since 1938: Goldilocks continues

At the end of April most investors were saying, "We'll take a rise of 12% year to date for the whole year. Let's pack up and go home now!"

The "sell in May and go away" mantra proved not to be worth paying much attention to either, despite a wobble during the last 10 days of the month, and now June has turned in the best performance for US equities since 1938. As a whole, US equities for the year are up 17.8%, including dividend reinvestment, and the performance of the FTSE All World Index is up 15.8%.

Usually, when equities are up, bonds are down, but not this year. The long bond index of US Treasuries is up 11% since January 1st, reflecting a negative outlook for interest rates, indeed markets are now forecasting the Federal Reserve, after misstepping and raising rates in November, will now cut rates thrice between now and end year in order to try to relieve slowing growth and stimulate corporate investment.

While the US market continues to outperform all others, this year there have been signs of life in European stocks (France and Germany up 19%, Belgium and Portugal up 11%). Emerging Markets too have rallied (India up 10.77%) and, with a forward view of greater certainty over a Brexit exit, UK equities have resurfaced (FTSE100 up 12.77%). Despite such heady returns already, equity investors could be set for a bumper second half to the year. Asia especially has room to do better in H2.

A few facts in support of continuing goldilocks:

- The first rate cut in the US when the US is not in recession, has led to a stockmarket rally 100% of the time. July is the month when the first cut is expected.
- The last week in June saw increased trading activity in the small cap indices, the Russell 2000 and the small cap 600. The small cap index has been subdued of late and markets need small cap stocks to be participating for the rally to continue.
- Not too hot? The Chicago Purchasing Managers Index fell in June against expectations. It registered below 50, a sign of economic contraction, when the expectation was a measure of 52.3. Many PMIs across Asia are also below 50.
- Trade talks between the US and China may be easing but geopolitical risks (Iran, Russia) still exist and have been borne out through higher oil prices and upward momentum in the gold price.
- Tech stocks are up 25% this year to date but nearly all of this gain is confined to software. The FAANGS, Nvidia, Micron etc are nowhere near their highs of June last year.
- Materials sector in the US was up 10% for June. 100% of the time after a 10% jump in materials, the sector is positive the following month with the average monthly gain thereafter, 4%.
- Chinese stocks have been weak this year until today. Chinese stocks are on the cusp of making a major comeback, and they'll lift the rest of Asia. Investor portfolios have to have exposure to emerging market stocks, especially Asia and specifically China and India for their long term health.

Gold's price rise in June was followed by an ascendancy in Bitcoin. Bitcoin's price ballooned to $19,650 in a canter during December 2017, since when the balloon steadily deflated to $3,183 in mid-December 2018. The price was £3,809 on March 1st this year and it has climbed steadily since to, today, $11,007, a reflection of its attraction, particularly in Asia, as an alternative to traditional safe haven assets such as bonds and gold. Having gone quiet for the best part of 12 months, Bitcoin debates have begun to resurface and in May, 50 businesses including traders and merchant banks, got together to develop a "deep, efficient and secure" market, according to the Financial Times.

Bitcoin's resurgence to the fore of conversation is aided by Amazon's recent filing for a "proof-of-work" crypto-currency system similar to Bitcoin's, and also most recently, talk of Facebook's own crypto-currency launch of Libra. This crypto stuff is getting serious. Interestingly, Amazon floated on the Stockmarket 22 years ago and $1,000 invested in them then would now be worth $1.2 million. Bitcoin on the other hand launched 10 years ago and $1,000 invested in that then would now be worth $2.6 billion - with a 'b'. Rakuten, the "Amazon of Japan", is talking about starting its own blockchain currency, as also is Samsung. The ultimate goal is to tie customers to an ecosystem. Apple has its own "stickiness" as Warren Buffett referred to Apple's ecosystem, which is being reinforced this year through the Apple Card, a tie-up between Goldman Sachs, Apple and Mastercard to offer incentives to customers who use it not only for Apple products but also more widely for everyday purchases.

Of the detail we know to date of those companies new to the crypto game, Facebook's is arguably the most controversial. Libra's value will be determined by the weighted average of a basket of currencies rather than by the traditional manner of supply and demand of the 'currency' itself, and given Facebook's proven abuse of its customer data already, its access to possession of customers' bank details is clearly concerning. One presumes safeguards will be put in place now to protect sensitive information from being distributed to all parts, but while faith in the world's central banks is being severely tested during a prolonged period of monetary easing which is suppressing bond yields and spiking asset prices, crypto assets are creating more than a stir. Given its susceptibility to wild fluctuation, investors dabble in it at their peril.

Green bonds, brought to the market by the World Bank in 2008 to raise money for the environment, have grown steadily in stature since, and the theme of Environmental, Social & Governance (ESG) has become the investment mantra for the next generation and the one after that. Yet much of the green bond issuance has gone to energy initiatives and precious little toward wildlife. Only 5-10% of the money raised through green bonds has gone toward biodiversity conservation projects, according to a report last month in the Financial Times. 85% of it has gone towards energy, buildings and transport. Renewable energy schemes are abundant and they attract capital because in many cases the revenue streams are quantifiable and reliable. With wildlife projects, they are the reverse: unquantifiable and unpredictable. How much wildlife will be saved as a result of a project and how soon will or can they become safeguarded and sustainable tourist attractions. Another problem is the lack of a regulated and systemised approach in controlling the investment and spend of a wildlife bond. Too often, and understandably, those behind wildlife projects are more concerned with doing good than the nitty-gritty of sound financial management and "return on equity".

Technical

There is much confusion over whether funding a pension in the UK is a good idea when it is close to the Lifetime Allowance (LTA, which currently £1.55m in the 2019/20 tax year). Granted, once growth or over-funding takes a fund over the LTA, a Lifetime Allowance Excess Charge applies (55% if the excess is accessed as a lump sum, 25% plus the marginal tax rate of the recipient if taken as income), however these charges only apply once the whole of the Lifetime Allowance has been taken (as income or as a lump sum or a combination of the two). Depending on how long it takes the pension fund owner to get through their pension, the LTA may not apply at all if legislation has done away with it by then, and having to pay an excess charge at all is usually a sign of strong investment performance together with higher rate tax relief on the way in. The LTA excess charge isn't great but it's a high quality problem.

Favoured investment plays:

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

Disclosure:

Nicholas Chappell has the following personal investment exposure: Technology (including new energy, all US) 14%, China 11%, Asia 11%, Pharmaceuticals 12%, Global Equity 15%, UK equities 11%, US equities 14%, Emerging Market equity 12%,

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