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Global Market Strategy - July 2021

Pandemic heightens awareness of vulnerability

Over the last 12 months there has been a greater understanding of the word ‘vulnerability’ and how it relates to individuals and businesses.

An individual can be vulnerable to making incorrect decisions in their day to day affairs because of an aspect of their health, because they have suffered bereavement, because they have lost their job or their business has failed, or for umpteen different reasons. There are many aspects of life which can lead to a person feeling vulnerable but for many, the left-field event of the pandemic and the impact on people’s mental state due a feeling of being cut-off from close friends and family has concentrated the need for ensuring their financial affairs are in order. This could mean a a need for greater life insurance, the use of trusts and powers of attorney, the rewriting of Wills, a more active interest and involvement in one’s investments and pension provision, or a combination of any these.

Despite the incredible rise of stock markets since the pandemic-driven market low of March 23rd 2020, there is concern that emerging markets in particular, where there has not been as concentrated a vaccination program yet as there has been in developed markets, are vulnerable to variants of the pandemic. As South Africa is experiencing, at least partial closures of the economy are an ongoing reality for the foreseeable future. Boris Johnson has stated the UK will definitely fully reopen on July 19th but the Delta Variant when given greater scope for spread, could bring us all back to restrictions of some sort in Autumn and Winter.

Central banks and governments have done a good job across the world attempting to help individuals and businesses through the effects of the virus. Ironically, in some cases this has resulted in a huge swathe of people being disincentivised to return to work. The hospitality sector has been especially hard hit in not being able to recruit, with people deciding to remain on government support in preference to receiving an after-tax income of virtually the same amount.

The low interest rate environment of the last decade has indisputably helped the world economy recover from the financial crisis of 2008. Since 2011the US SP500 index has compounded very nearly at the elixir rate of 15% per annum where capital doubles every five years. For an index of 500 stocks to achieve a compound growth rate of 15% over 5 years is scarcely believable, yet US corporate earnings growth is set to continue as personal spending grows and corporate capital expenditure widens, most notably in technology to compensate for the difficulty in acquiring labour.

US markets continue to set new record highs, sparking fears as always of at least a 10% correction at any time. Bearing in mind there hasn’t been a correction of more than 7% since September 2020, one is overdue but attempting to be ahead of it by selling and hoping to buy in later at cheaper valuations is a dangerous game. The key as ever is to be well diversified but not so diversified as to dilute the opportunity for good performance.

Fed chair Jay Powell has moved marginally toward market thinking that some move in rates may be necessary in late 2022. HIs statement in June was met with an equity sell-off but the sale lasted two days before markets realised that any interest rate moves would be minimal. US tech stocks are back in favour, having been outshone since March by the value rotation. Across US indices it is tough to find stocks to buy which are not already highly priced.

The energy sector has been the best performing sector this year with Brent oil up 48% as roads have retuned apace to pre-pandemic levels of traffic. International travel has had negligible increase in traffic following the easing of domestic restrictions. People are still wary of leaving for foreign soil, firstly because they don’t fancy being stuck on a plane for a few hours next to someone they don’t know, and secondly because of concern the rules over testing and quarantining may change while they’re away. Road traffic has increased now that fewer people wish to travel to work by public transport. Share prices for energy companies such as Shell, Chevron, Total are forecast to keep rising, and all the big oil producers’ share prices are up between 80-100% year to date.

Higher petrol prices have a noticeable impact on a consumer’s affordability elsewhere. It is to be hoped that Saudi Arabia and Iran will come to some sort of rescue by pumping more oil. OPEC estimates the world will be consuming two and a half million more barrels a day of oil by the end of the year. Unless there is agreement in OPEC to produce more, the supply-demand balance will be out of kilter, resulting in higher prices at the pump.

Aside from the success of the US stockmarket, the second best equity market performance year on year for the last decade has been Japan, with a compound annual growth rate of just under 10%. Thanks to the opening up of the economy under the previous prime minister Shinzo Abe, Japan is seen as a more transparent and better regulated market than most of its Asian neighbours, yet offers close access to them.

In contrast to the US and Japan, the UK All Share market has performed poorly over the last decade, as have - due a strengthening haven status of the US dollar - emerging markets (EM). Both the UK and EM showed an annual compound return of less than 3% over the last 10 years. The UK market is an opportunity area for investment, seen by many fund managers as undervalued and underowned. The FTSE100 and the FTSE250 are both up nearly 10% year to date.

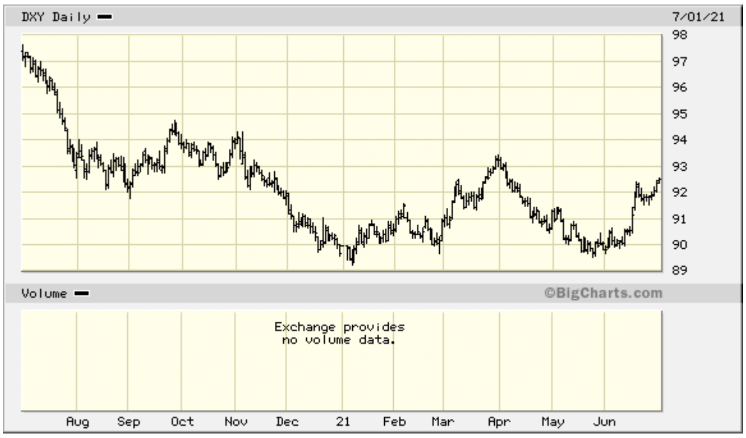
In Europe, the MSCI Europe Index, a broad index of European stocks from across different sectors, is itself up 12% for the first half, with many value companies (those that offer a dividend and, usually, good cashflow ie banks, autos, industrials) up over 40% for the first six months of 2021.

On the commodities front, lumber, which tripled off its lows earlier this year, fell 43% in June, unsurprisingly its largest ever monthly loss. Gold also had a poor month in June, recording its biggest monthly drop for four years due a strengthening dollar. The US dollar rose 2.5% in June due to two factors: a greater likelihood the Federal reserve will increase rates two years early, and due to an expected 700,000 jobs added to the workforce in May (on the back of 559,000 jobs added in April).

The SP500 is now up 90% since the bear market pullback in March 2020, and it's up 12% in the first half of 2021. Only once in history has the market completely given up a 12% fist half gain - in 1987. The SP500 has had five straight monthly gains and the Nasdaq us up in each of the last 5 quarters.

Volume of trades has increased markedly both on the buy ('calls') and sell side ('puts') of the options markets. This is alarming as it shows traders are unsure of the direction of the market. Peter Najarian of the trading education site Market Rebellion, pointed out on CNBC last week that two years ago a big day in the options market would be have been 20 million trades in a day; the current daily volume is 35-50 million contracts which Najarian believes is extremely bullish for the financials.

It should be possible for equities to continue their gains of the last twelve months, especially in Europe and the UK because of the near certainty of interest rates remaining very low or even negative. Increased exposure to those areas where the demographic is changing will be important, viz the Far East which will give long term outperformance albeit amid interim volatility, and there is no point selling a portfolio in anticipation of a 10% pullback because although it will inevitably come, investors could miss out on a 15% rally in the meantime.



US dollar index, 12 months (Source: bigcharts.com) - under 94 has historically been seen as encouraging for equities

Favoured investment plays:
Nil risk:
Cautious risk: Cash
Balanced risk: **Managed / Multi-asset funds**
Market risk: **Multi-asset funds, UK equity**
Adventurous risk: **Asia, Europe, Japan, US equity**
Speculative risk: **Technology, Energy, Platinum, Emerging Markets**

Disclosure:
Nicholas Chappell has the following personal investment exposure: Technology (all US, including fintech) 17%, Energy 19%, China 11%, Asia 9%, Global Equity 6%, UK Equity 10%, European equity 11%, US Equity 3%, US smaller companies 1%, Emerging Market equity 9%, Platinum 4%

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