Investment Review – July 2019

As 2018 drew to a close, investors around the world were increasingly worried that we were heading for a recession. As a consequence, equity markets had fallen sharply, virtually eradicating the gains of the previous two years. Sentiment has now swung around once again and for all the disruptive possibilities, the view that Central Banks will ride to the rescue with interest rate cuts has prevailed. The result of this about-turn in sentiment has been that equity markets, as well as bonds, have shown gains over the past six months that have cancelled out the losses of the latter part of 2018. The wider index of the U.S stock market, the S&P 500, has recorded a gain of 18.5% in the first six months and, even though the FTSE 100 looks weak in comparison, it has still managed a rise of 13.1%.

The desire of the President of the USA to confront China with a tariff war was one of the primary causes of equity markets falling to such as extent at the end of 2018. It now appears that he wants to reach a brokered agreement and markets have concluded that the outcome of the trade dispute will not be an all-out trade war, with recession and inflation as consequences. The apparent truce that has been declared between the two most powerful economies on the planet was sufficient to power equity markets to new highs in June, with the USA rising by 6.0% and Emerging Markets (of which China is the largest constituent) gaining 5.3%. We do however remain concerned about the potential for further market volatility, not least because it has become impossible to predict Trump's strategy, if indeed there is one.

Whilst many global issues seem less pressing today than they did at the start of the year, the same cannot be said of matters in the UK. With Parliament unable to digest anything beyond the single dominant issue of Brexit, and the choice of a new leader of the Conservative Party about to morph into the leader of the country, it is understandable that our own equity market has been one of the poorest performers amongst the Developed Markets over the past two years. The weakening Pound has helped to mask this, earnings from overseas have become more valuable when translated back into Sterling and this has had a beneficial impact on many stocks within the FTSE100. The uncertainty surrounding the UK economy is one of the main reasons for us choosing to have considerable exposure to overseas equity markets, rather than portfolios heavily skewed to the UK market.

Equity markets have not been alone in seeing a strong recovery in the first half of 2019. The view that interest rates will be cut in the USA has ensured that bond prices have also seen gains. This has led to the welcome scenario where not only have adventurous investors benefited over the past six months, but so too have the more cautious, who have a higher exposure to government bonds. The index of UK Gilts rose by 5.0% over the period, slightly below that of U.S Treasuries, but still appreciably ahead of the return that could be gained just by holding cash.

Whilst we should welcome the increase in price of these bonds, the flip side is that the yield on such fixed income investments has edged even lower. We are now at a point where a large swathe of government bonds now have an income yield of less than zero. According to Bloomberg Markets, almost the entire $850 billion German Government Bond issuance is poised to yield nothing at all. One almost has to read that twice to ensure that it isn't a typing error. The currency printing press working overtime has led to worries that we will see a recession, higher inflation and the erosion of monetary value. This in turn has led to some institutional investors being prepared to accept a zero (or less) return, in exchange for the guarantee of the return of their money. Whilst this is acceptable for some institutions, our preference is for Corporate (company) debt, where some semblance of value still exists and where, combined with equities, property and other alternatives, we can provide a balanced portfolio that will produce steady gains with low volatility over the medium to longer term.

Yours sincerely

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