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Global Market Strategy – September 2017

Sentiment rattled by terror attacks and Trump leadership failings - but no change to investment goals

Hurricane Harvey, which struck Texas with immense devastation and yet comparatively little loss of life, came and went amid the Summer holidays, more muscle-flexing from North Korea, a weakening US dollar, higher gold prices and, it has to be said, no real pull-back in equity values.

Europe is the one area where equity prices have fallen demonstrably, particularly in Germany where the DAX has fallen from 12,948 in mid-June to 12,100 now (August 31st) due to the ever-strengthening euro. The euro is gaining traction because of a change in sentiment toward interest rates buoyed by better data in the eurozone. Gentle ECB noises to do with taking its foot off the QE pedal are also supportive of improving sentiment toward the single currency, but just as in the US and UK, there aren't going to be any rate rises while there is uncertainty over economic growth, job prospects and Brexit.

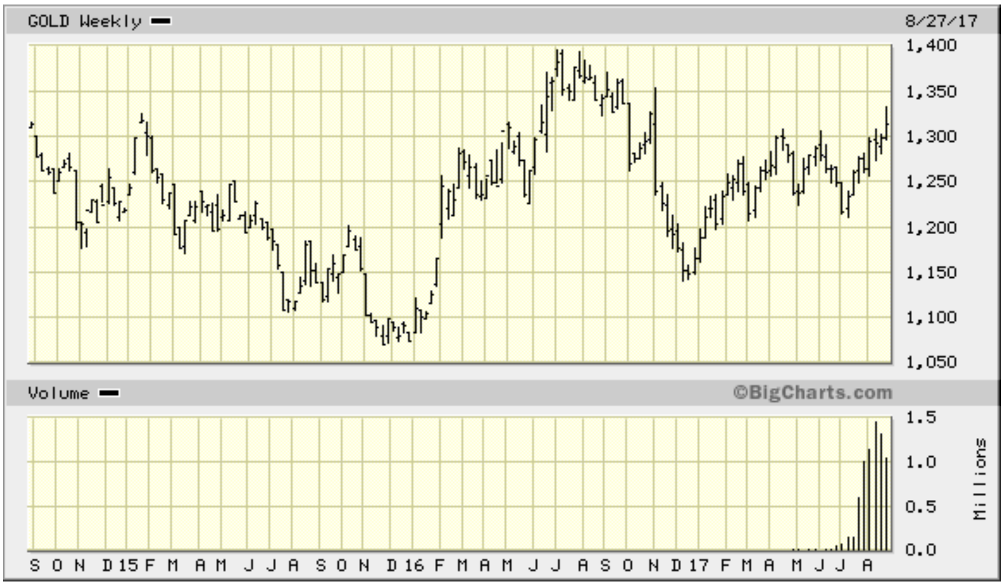
Dax futures, 6 months to August 31st 2017 (Source BIgCharts.marketwatch.com)

The apparent lack of any impetus behind any new tax and infrastructure deal in the **US**, coupled with a lack of enthusiasm for any further interest rate rises until perhaps November or December - perhaps not even until next year, has led to dollar weakness in spite of nuclear missiles being fired over Japan. Geopolitical tensions would normally result in a spike in the dollar index but it barely moved following the latest provocation.

The dollar index, or DXY as it is known, rose to 103.82 at the turn of the year, and is now at 93, having fallen to 91.6 in recent days. A weaker dollar is a big deal for **emerging markets**, much of whose debt is in dollars and therefore any weakening makes repayment just that little bit easier. Yet that is not the whole story. While a weaker dollar offers assistance to US exporters, it makes exporting to the US an uphill battle for all markets, and if the dollar weakening continues, it could lead to a currency war. Darryl Guppy, an independent technical analyst, sees support now at 93 against any further fall, however continued US political instability, or at least a perception of it, could easily lead to renewed weakness down to the next support level at 85. 85 used to be seen as the tipping level beyond which, on the upside, equities would struggle. Such is the 'new norm' of low interest rates, low inflation and low wage growth that some previously ruled lines-in-the-sand have had to be redrawn.

The prospect of a currency war would be gris-to-the-mill of **gold** investors. It would fuel the feeling of needing to hold an alternative currency, one that cannot be printed or, theoretically, controlled. Gold has seen strong gains this year, rising from a low of $1140 to a high amid the latest nuclear missile launch, of $1331. Many traders now expect a run toward $1400 per troy ounce for the yellow metal amid a number of supporting factors: geopolitical tension, US political instability, a weaker dollar - and ongoing negative real interest rates. Short term US Treasury yields have bobbed up and down as expectations of interest rate rises from the Fed have waxed an waned but longer term Treasury yields have fallen in line with a lower interest and inflation rate outlook. This places greater measure on gold as a store of value, especially since the opportunity cost of holding it remains negligible - and it acts as some valuable insurance if something triggers an equity market correction.

Dollar Index (DXY), 12 months to August 31st 2017 (Source: BIgCharts,marketwatch.com)



Gold 3 month futures, 3 year chart to August 31st 2017 (Source: bigchart.marketwatch.com)

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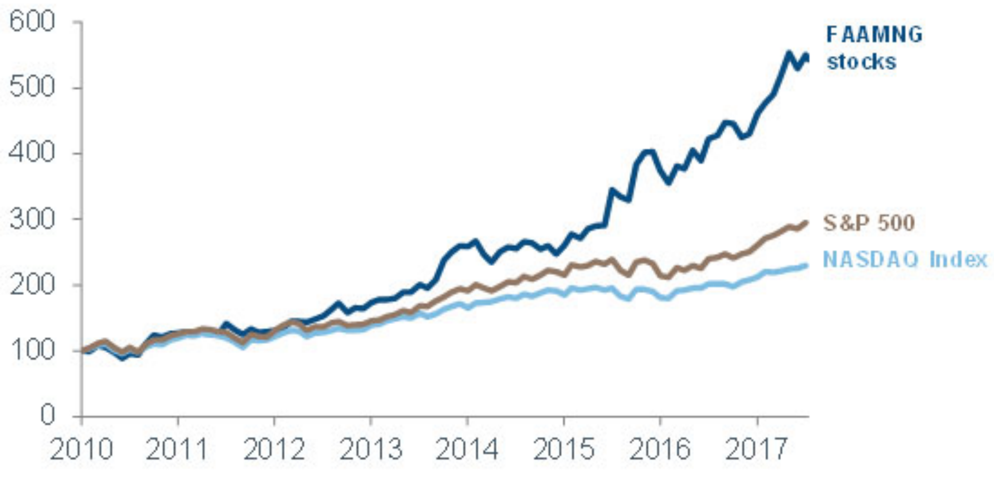
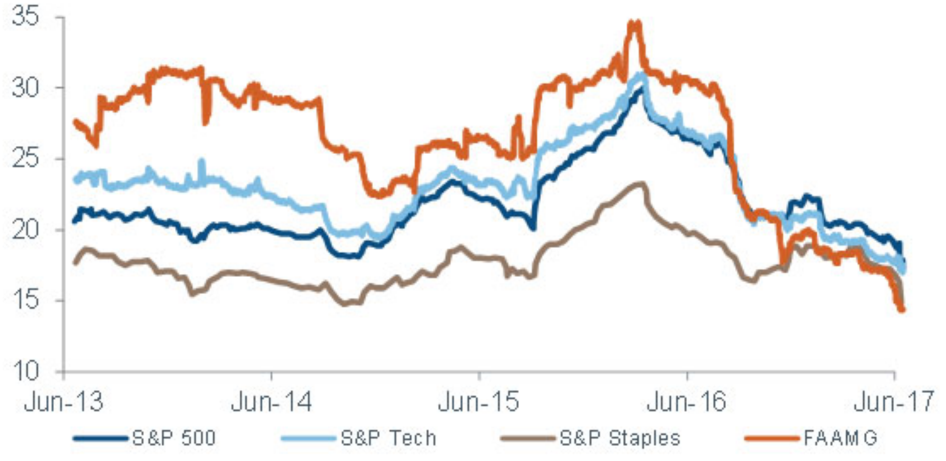
The shares of **Facebook, Amazon, Apple, Netflix, Microsoft and Google** have all boasted strong returns over the past year, together accounting for almost half of the total return of the S&P500 despite making up only 15% of market capitalisation. Other than Amazon which trades on a trailing PE of 244, these tech stocks do not carry the same ‘crazy’ valuations of the Dotcom boom and bust of 1999/2000. Indeed Apple trades on just 18 times trailing 12 month earnings and has more than $260bn in cash on its balance sheet. Apple offers a yield of 1.64% and a return on equity (ROE) of more than 36%. The cash position would allow it to make a special dividend payout to shareholders if it doesn’t make an acquisition in the near future. Apple, Facebook and Microsoft have risen 54%, 35% and 28% respectively this year. Max Wolff, chief economist at Disruptive Technology Advisers, acknowledges that of course tech stocks are expensive relative to their recent past, “but their still growing”, he says. "They still have great margins. So we still think they're the place to be [but] I just think you have to keep your eye on where the exit is in all of these risk assets”. Mr Wolff affirms: “For now, tech is the expensive but best place to be”.

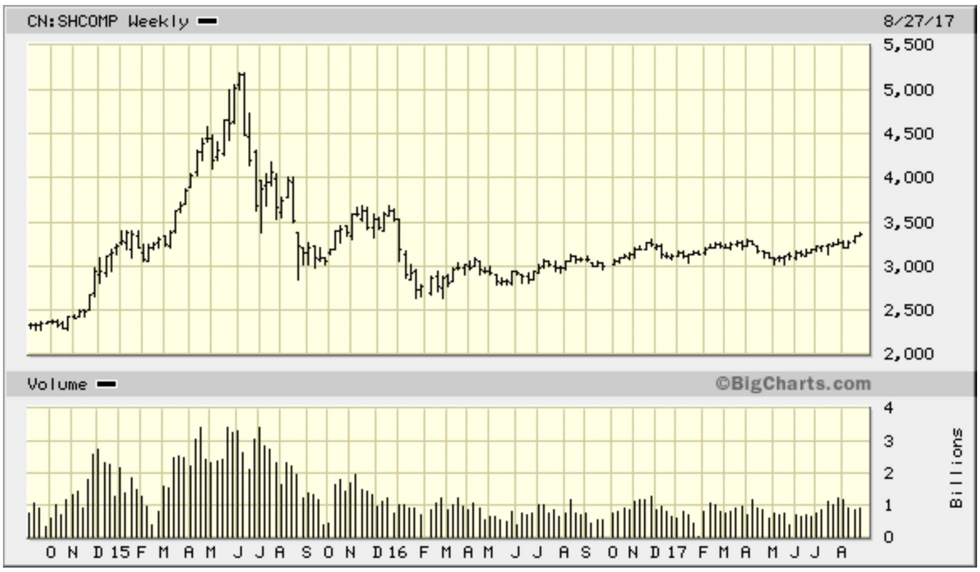


FAAMNG: Facebook, Amazon, Apple, Microsoft, Netflix and Google. Price return rebased to 100 on 01/01/2010 (Source: Fidelity International, Bloomberg, August 2017)



Source: Goldman Sachs, Fidelity International, June 2017.

Emerging markets have been on a tear since the turn of the year, **China** especially. We saw a blow-out phase in the China market in mid-2015 during the property boom and bust but since then things have been more measured.



Shanghai Composite Index, 3 years to September 1st 2017 (Source: BigCharts.marketwatch.com)

Analyst Darryl Guppy has again been on the case and has detected a 'double bottom breakout' pattern for the Shanghai index. "This is a classic indication that bullish momentum is building into a new uptrend", he said on CNBC recently.

The breakout first closed above the value of a resistance level near 3130. This rally was the beginning of a change in direction and was confirmed by a move to 3143 on May 31. There was then a retreat from 3143 temporarily before a strong rally on June 7. The index has moved ahead well since June, and now trades at 3367, but importantly the rise is measured and not extreme. Now that the Chinese have 'got capitalism', for all the concerns about the putting out of 'misinformation' this is a market which should form a part of every long term portfolio, either via an emerging markets fund or more directly via a well-managed China fund.

MSCI Emerging Markets Index XX:891800, 12 months (Source: [BigCharts.marketwatch.com])

Favoured investment plays:

Nil risk: USD cash (in preference to Euro cash)
Cautious risk: AAA Corporate
Balanced risk: Managed / Multi-asset funds / Long-Short Absolute Return funds
Market risk: UK, **European equity**
Adventurous risk: **Japan, Asia, Germany,** US equity, UK/European/US smaller company sector
Speculative risk: **Water, Technology, China, India, Other EM**

Disclosure:

Nicholas Chappell has the following personal investment exposure: Technology, (including new energy, all US) 29%, Global Equity 17%, US smaller cos 2%, (Other) US equity 5%, UK equity 3%, Germany 5%, (Other) European equity 9%, India 4%, (Other) Asia 10%, Pharmaceuticals 11%, Precious metals 5%