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Global Market Strategy – August 2018

- ***Investors withdraw from equities to favour cash***
- ***… but the case for US stocks "is as strong as it has ever been"***
- ***MAGA: Make America Great Again - or alternative tech acronym?***
- ***Where to invest next - Emerging Markets?***

For the first time since 2008, cash is returning something - not much in sterling terms (typically up to 1.30%) but sufficient to make investors question whether they should bank profits and place at least some of their portfolio on the sidelines in cash.

UK cash returns are insufficient to keep up with 2.5% inflation but US dollar investors have a slightly greater incentive to hold cash, deposit accounts for the greenback typically offering up to 2.5%.

There is no doubt investors are nervous. They are pulling cash from equities and "pausing". In an interview with Bloomberg last month, BlackRock CEO Larry Fink said that of the $6.3 trillion dollars managed by the company, inflows of new money are the slowest they have been since the second quarter 2016. "Clients are pausing because they are confused as to which direction the market is headed, and they're questioning the whole foundation of international investing."

Fink said that there is nervousness among retail investors as to how the trade war will play out, and if it does develop into a full blown event, then he would expect a "10-15% pullback in stocks and a slowdown in economic growth in 2019". Yet there is reason to be optimistic, he argued, since 1st quarter earnings were stellar and 2nd quarter earnings are being declared now at extremely high levels, giving rise to some $800 billion in stock repurchases and record merger and acquisition (M&A) activity. Fink said that with such outstanding market numbers he would have expected the equity market to be up 10% from current levels, agreeing with Bloomberg interviewer Erik Schatzker that the S&P500 should not be 2800 (currently 2818, close, July 31st) but 3100.

So should investors be pausing now? Yes, if they need capital in the next five years, said Fink, "but if they're saving for retirement, absolutely, they should still be investing".

James Bevan, CCLA Investment's Chief Investment Officer, concurs with Larry Fink: "The case for buying US equities is as strong as it has ever been", he said on Bloomberg last week. Europe on the other hand is not as strong as was expected at the start of the year, impeded by slower export and domestic growth.

Mohammed El-Erian, former CEO at PIMCO and now chief economic advisor to Allianz, the corporate parent of PIMCO, is also bullish on US equities but now "it's s stockpicker's market", he said last week on CNBC. "People fell in love with liquidity forever and synchronised global growth forever". We are now in a period of normalised growth, he said, and that means greater, more normal volatility.

The US stockmarket is, however much we may find it incredulous, healthy. "The trend is your friend", and fighting the trend by pulling money out of the US market could be costly. The S&P500 is not at overinflated levels but its appeal is now narrow, and therefore passive exchange traded funds, while cheap, are probably not the place to be. Individual stocks with strong cashflow, an active business model and large moats - these are the companies to look for. It may be that instead of concentrating on Facebook, Amazon, Apple, Netflix and Google, tech investors should be more interested in amending FAANG to MAGA: Microsoft, Amazon, Google and Apple. According to CNBC, Google's cloud business is small compared to Amazon and Microsoft's "but it's still making at least £1 billion revenue per quarter". Facebook's alternative enterprise business is "almost non-existent". As for Netflix, there is an increasing feeling Google and Disney could soon take away subscribers from Netflix. Currently, Netflix has a deal with Disney to exclusively show Disney's content through its streaming service, however the agreement, entered into in 2012, comes to an end next year when Disney will be launching its own streaming facility.

The important point about markets now is that we are undoubtedly approaching the peak of the economic cycle, which does not mean yet reducing exposure to the US market, for reasons mentioned above, however, with the start of money policy tightening as opposed to quantitative easing, investors have to be preparing for a reallocation of assets to areas which are inexpensive and which will offer attractive growth opportunities.

Emerging markets (EM) are currently at a very important technical level, see the chart below. If a line were drawn across the page from top left (April 2007) to bottom right (brushing the top of the peak of the blue EM graph at November 2015), a break-out can be seen to have developed. Until this year, the line across the page depicted resistance to any break-out. Now that the break-out can be seen clearly, the index must hold above the line in order for hitherto resistance to be confirmed as support for the future. If the line is broken to the downside, the upside move will have shown itself to be a 'bull trap" but if it is confirmed as support, we could be about to enter a period of significant upside for emerging market equities - so says Tiho Brkan of The Atlas Investor in the first of two podcasts on "Where to invest your money Next?" at https://theatlasinvestor.com/where-to-invest-your-money-today-part-1-of-2/

MSCI CUMULATIVE INDEX PERFORMANCE - NET RETURNS (USD JUN 2003 – JUN 2018) (Source: msci.com)

Tiho Brkan makes the point that such is the bullish sentiment toward the dollar at present that that is of course a headwind to EM progress, however if, as was suggested in last month's bulletin, we are already two-thirds through the current dollar upswing, forward thinking investors should consider a reallocation of some developed market exposure to EM.

It should also be pointed out that developed market growth is estimated at an average of 2% for 2018 (although the US could grow by as much as 3%) yet EM growth is projected to average 4.9% this year and 5.1% in 2019, according to a research paper last month from FMG Malta Limited, assisted by Bloomberg and data from the IMF (see below).

	Estimate		Projections	
	2016	2017	2018	2019
World Output	3.2	3.7	3.9	3.9
Advancing Economies	1.7	2.3	2.5	2.2
US	1.5	2.3	2.7	2.5
Euro Area	1.8	2.4	2.2	2.0
Germany	1.9	2.5	2.3	2.0
France	1.2	1.8	1.9	1.9
Italy	0.9	1.6	1.4	1.1
Spain	3.3	3.1	2.4	2.1
Japan	0.9	1.8	1.2	0.9
UK	1.9	1.7	1.5	1.5
Canada	1.4	3.0	2.3	2.0
Other Developed Economies	2.3	2.7	2.6	2.6
Emerging Markets	4.4	4.7	4.9	5.0
CIS	0.4	2.2	2.2	2.1
Russia	-0.2	1.8	1.7	1.5
Excluding Russia	1.9	3.1	3.4	3.5
Emerging Asia	6.4	6.5	6.5	6.6
China	6.7	6.8	6.6	6.4
India	7.1	6.7	7.4	7.8
ASEAN	4.9	5.3	5.3	5.3
Emerging Europe	3.3	5.2	4.0	3.8
Latin America and Caribbean	-0.7	1.3	1.9	2.6
Brazil	-3.5	1.1	1.9	2.1
Mexico	2.9	2.0	2.3	3.0
Middle East, North Africa, Afghanistan & Pakistan	4.9	2.6	3.4	3.5
Saudi Arabia	1.7	-0.7	1.6	1.9
Sub-Sahara Africa	1.4	2.7	3.3	3.5
Nigeria	-1.6	0.8	2.1	1.9
South Africa	0.3	0.9	0.9	0.9

Chart shows Economic Growth estimates and projections (Source: fmgfunds.com)

Favoured investment plays:

Nil risk: Cash
Cautious risk: AAA Corporate bonds
Balanced risk: Managed / Multi-asset funds / Long-Short Absolute Return funds
Market risk: **UK,** European equity
Adventurous risk: **Japan, Asia, US equity, UK**/European/**US mid & 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) 39%, Global Equity 16%, US smaller cos 3%, (Other) US equity 9%, India 4%, China 4%, (Other) Asia 10%, Pharmaceuticals 14%, Cash 1%

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