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Independent Financial Advisers
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Market review - December 2018

As we approach the end of the year, we reflect on what has been a difficult 12 months for the markets and look forward to 2019.

2018 is on course to be the worst year on record in terms of the percentage of global assets down in US dollar terms, although £ Sterling investors fared better due to the relative weakness of the pound. Investors have become increasingly concerned about the global economy as data continue to suggest a slowing rate of expansion. Market volatility across assets for much of this year has arguably been related to the conflicting pressures of rising interest rates and fears of weaker growth

The financial crisis of 2007-08 was followed by 10 years of good times as the global economy was boosted by central banks using a combination of low interest rates and quantitative easing. It was a period of unconventional monetary policy that lasted much longer than virtually all experts predicted, leaving global markets with a bigger hangover than anticipated. In the last four months, markets seem finally to have woken up to this new dawn of fading central bank support. Investors seem unsure how the global economy will fare in a higher interest rate environment sparking the market volatility we have seen across both the equity and bond markets.

Whilst we do not see evidence of recession in 2019 the markets face challenging headwinds. The US economy remains supported for at least another year by President Trump's $1.5 trillion package of tax cuts which delivered sizeable reductions in both corporate and individual tax rates. However, with an unemployment rate of 3.7%, its lowest level in 49 years labour market conditions are tight and wages recorded their largest annual gain in 9 ½ years in October 2018. Therefore, I would expect the US Federal Reserve to continue its policy of measured interest rate rises.

Theresa May's recent decision to delay Parliament's vote on her Brexit deal has kicked the Brexit can further down the road. By the time you read this there will have been further developments, but continuing uncertainty will unsettle markets with the pound and risk assets exposed to the UK economy taking the brunt of further sell offs.

We also had confirmation from the European Court of Justice that the UK is legally able to revoke Article 50 without the consent of the EU27. This effectively means that now all options are on the table, from a "no-deal" Brexit to no Brexit at all. This makes for an extremely complicated possibility of outcomes. Based on what we know now (which could, admittedly, change before you even read this), what are the options?

The three main outcomes that are left on the table are:

1. Deal (on whatever the PM comes back with, if anything)
2. No deal (which is the most disruptive economic outcome); and
3. No Brexit (which could be the result of a further referendum, if offered. It is hard to see Parliament taking that course by itself).

The fact that there is no consensus in parliament means that the odds of another referendum have narrowed recently, although it comes with its own particular threat. However attractive a no-Brexit scenario might appear to the business community, there is no doubt that it risks undermining the democratic process, a view that has informed Mrs May's approach from day one. Brexiters definitely feel that they won fair and square and if they have that victory snatched away it threatens an inflammatory reaction in what would become a highly polarised country. If Mrs May has deliberately pushed the Parliamentary vote to January with the intention of forcing MPs to choose between her deal and no deal, then it is a high-risk strategy.

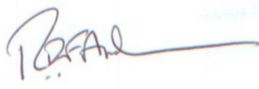
From an investors perspective there is still a big gap between the extremes of possible outcomes, which can be seen in the market's projections for the value of the pound down 10-15% in the event of a no deal versus up 10-15% if we have no Brexit.

It is difficult to look beyond Brexit but there are reasons to be hopeful for UK assets as we look ahead to 2019. Some clarification in the relationship between the UK and the EU should act as a catalyst for investors to revisit the UK equity market as a destination for capital. A relief rally is entirely possible, and this could be sustained as investors re-focus on fundamentals. Attractive valuations can be found across the market, in large and small companies, both international and domestic-facing.

The UK market is cheap on a relative basis, currently trading at 12x earnings compared to 14x for Europe ex-UK and 17x for the US. Individually UK companies are looking very good value versus their International peers e.g. Aviva is trading on 7x earnings versus 10x for Allianz. The number of unloved companies available to choose from means that 2019 could turn into a surprisingly positive year for investors brave enough to buy UK equities before the good news.

We continue to believe a well-diversified approach is the best way to shield investors from the vagaries of economic and political events. Please contact us if you would like to review your investments.

Kind Regards



Ross Anderson ACSI | Gavin Anderson CeMAP MIFS DipFA | December 2018