

Market Review - September 2020

The global economic recovery seems to be in place. The Purchasing Managers Index (PMI) is a key measure of the prevailing direction of economic trends and for manufacturing and services the August numbers in most countries looked positive. However this recovery is patchy with significant areas of disparity and this has been reflected in performance of different stock markets.

The summer has seen plenty of sunny days for capital markets. In Sterling terms, all major stock market indices posted positive monthly returns in August, with the MSCI world index jumping 4%. This takes global equities past their pre-crisis levels to a positive return year-to-date. The US was one of the leading performers over the month as it has been since the beginning of the year. Despite the COVID-19 crisis the S&P 500 has risen 8.6% year to date (31.8.20). This contrasts with our own market where the FTSE 100 trades 19% below its starting level at the beginning of the year. Europe has performed better as measured by the MSCI Europe ex UK but it is still down 2% year to date (ytd).

Even in the US a positive overall return for the S&P 500 index (+8.6% year to date) hides a huge divergence between US sectors. The NASDAQ – which is much more heavily weighted towards the American tech sector – has a year to date return of over 30%. The incredible performance of the US mega-cap tech companies – and how concentrated the market rally has been on them – has led to some investors getting vertigo, worrying about climbing valuations as hitherto healthy underpinning earnings are proportionally becoming ever smaller relative to share prices. This fear could well have been a part of last week's sell off.

The divergence between America's business sectors haves and have-nots is an unhealthy sign. For the tech superstars and the consumer discretionary sector, the US is looking good. Not so much for everyone else. The US still leads the world for now, but the underperformance of large sections of the American economy – combined with weakness in the US dollar – could be a sign that investors are starting to look elsewhere.

The key thing to watch will be whether the world's central banks continue to slow the pace of the massive liquidity injections that have been a feature of the pandemic support effort. Reduced liquidity could trigger greater volatility and a rotation away from the US large tech. Last week's sell off could be a taste of things to come...

Central bank and government support measures are easy to gauge: it is much harder to work out the consequences of the public health impact of the virus, and how we behave relative to this threat. Europe is in the midst of a second wave with infection rates back to April highs in some countries. COVID-19 fatalities have only marginally risen so it seems unlikely at this stage that governments will revert to nationwide lockdowns. It is more likely that how we respond as a society to the virus threat that will determine whether the economy continues to rebound as strongly as it did over the summer, stalls, or reverts back to decline.

Positive news on the medical response will help. News that AstraZeneca is about to put its potential Covid-19 vaccine through final-stage trials has fed hopes of a vaccine breakthrough. This continues to provide support to markets, however we still don't expect widespread vaccinations until the mid 2021.

September will be a crucial month. If the gradual return of children to classrooms and workers to offices that has taken place across Europe continues and takes hold in the UK as well, then the economy will continue to recover. If fear returns, then economic prospects will be much harder to foresee and so will the corporate earnings recovery. We believe that the positive scenario carries a higher probability than the fear scenario,

but it is entirely possible that over the coming weeks, stock markets will be buffeted between these two opposing economic prospects. The roller coaster stock market ride we experienced over the past week may therefore become much more frequent than it has over the summer months.

We continue to review client's portfolios and believe that a well diversified portfolio provides the best opportunity to minimise short terms losses (/drawdowns) and maximise the chances of achieving our clients' long terms goals.

Property funds

Since lockdown (and before lockdown in the case of M&G's property fund) we have seen most of the main open ended commercial property funds suspend dealing. There has been a lot of speculation about the suitability of "bricks and mortar" property portfolios for open ended unit trusts. The challenge of raising liquidity, i.e. selling properties, to meet fund holders' withdrawals is behind the fund suspensions. The illiquidity of property assets is not a new issue but the recent crisis has triggered an ongoing investigation by our regulator, the FCA, into the long term viability of this type of property fund. What this means in the short to medium term for investors is unclear - one of the new rules as proposed would require investors to give notice – potentially of up to 180 days - before their investment is redeemed. This will be a big change for funds that have historically dealt on a daily basis.

We will be talking to clients about these changes and about our thoughts more generally on the economy and suitable investment strategies, but you please feel welcome to contact us if you have any questions or concerns.




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