INVESTMENT MARKET UPDATE

January 2020

Canaccord Genuity Wealth Management

'Steady as she goes' in 2020

2019 was a vintage year for markets, and especially equity markets. Of course, 2018 had ended in some turmoil so the starting point was low, but even so, last year provided a bonanza for investors.

US equities led the way and ended up 25.7%, driven by extraordinary returns from the biggest technology companies. The share prices of the top four, Apple, Microsoft, Alphabet (the owner of Google) and Amazon – which all have market capitalisations over US$1trn – rose by 58%, 89%, 28% and 23% respectively over the year, including dividends.

To put this into context, the sterling market value of these four US companies comes to a combined £3.5trn (at the time of writing), which is one third greater than the £2.6trn value of the 628 companies making up the entire UK equity market (FTSE All-Share Index).

Not that the UK did badly last year either. December's decisive general election result saw the risk of a Jeremy Corbyn-led socialist government evaporate and the elimination of Brexit uncertainty. Both equities and sterling rejoiced by bouncing sharply. In fact, after a long period in the doldrums, the FTSE 250 Index of smaller and mid-sized companies performed even better than US equities, with a rise of 28.9% – and this for a market without the likes of the US tech titans.

In the end, all the major global asset classes rose over the year. Measured in sterling and including income where appropriate, the FTSE All Share (which includes the larger-company FTSE 100) climbed 19.2%; world equities excluding the UK were up 23.1%. UK gilts, despite hitting all-time low yields during the year, climbed by 6.9%, and UK corporate bond yields were up 11.0%. Defensive gold was up by 14.2% over the year, although the bounce in the value of the pound meant that sterling-based investors saw a small fall in the final quarter of the year.

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Where to now for markets?

We've started 2020 with equity markets shaking off a major bout of geopolitical nerves after the assassination of Iranian general Qasem Soleimani, and investors enthusiastically embracing the signing of a 'phase one' trade deal between the US and China. The US market is up nearly 4% in sterling already this year.

After all this excitement it's fair to ask, where now? Pause for breath? Market fall? Or onwards and upwards?

We don't expect to get the same stellar returns from equities in 2020 as we had last year. Two consecutive years of such high returns would be heroic, especially as valuations – in the US at least – have become a little expensive, and we now need company profits to grow into their expanded ratings.

However, while prospects for shares may not be quite as bright today as they were a year ago, many of the factors that drove their returns last year remain in place, and in some instances some of the uncertainties that provided headwinds have dissipated:

- **Interest rates**, which were led down by the US Federal Reserve (Fed) last year, remain low. Indeed, in the UK they are expected to be cut early this year and China has been busy reducing theirs over the last few months. There seems little prospect of them rising anywhere significant in the world in the near-to-medium-term future, especially as inflation remains very low too.
- In addition to ultra-low and stable interest rates, **global money supply** is growing quickly. In the US, so called 'narrow money', which includes cash and near cash-like bank deposits and money market funds, is growing at a 12% annualised rate, while the equivalent measure in China is up by nearly 9% on the same basis. At times when inflation is low, increased money supply often ends up invested in financial assets like equities.
- After a weak patch in the second half of last year when US 10-year bond yields fell briefly below their two-year equivalents (historically a fairly reliable recession indicator) – **global leading economic indicators** have begun to show signs of life. Typically, this is good for future earnings, which helps sentiment since growth in earnings would justify the elevated valuations that equities enjoy at the moment.
- Even with that weak patch, **unemployment** remains low in the US, UK, Japan, and Germany as well as several other European countries. Consumers with jobs are enjoying real increases in earnings, which is good for their spending power (although these increases are not strong enough to prompt central banks to increase interest rates). This increase in earnings underpins steady consumption growth, and consumption is the largest component of most developed economies.
- **Trade and political headwinds** are also abating. In the US, the 'phase 1' trade agreement with China has taken the sting out of fears that increasing tariffs may derail global economic growth. In the UK, of course, certainty over Brexit (although not yet on the UK's future trading relationship with the EU) means that companies can begin to plan with greater clarity.

For these reasons, we remain positive on the outlook for riskier assets, despite their gains and the record highs they continue to make.

This was how we exited 2019, and for the time being we see no reason to change course. At the moment and all things being equal, we would use any potential fall, or correction, in markets (which is all but inevitable at some point) as an opportunity, rather than a threat.

"Keep your hand steady on the wheel, helmsman!"

This article was written for you by Richard Champion, Deputy Chief Investment Officer, UK.

Our investment views as at January 2020

The view in this table refers to our balanced, risk profile 5 model portfolio. This risk profile has a benchmark with 57.5% in equities, 35% in bonds, 5% in alternatives and 2.5% in cash.

Indicative positioning of £ 'balanced' portfolio.

Asset class positioning	--	-	=	+	++	Outlook	
Alternatives				■		→	Gold and infrastructure are more attractive than hedge funds.
Bonds (Govt)	■					↓	Government bonds are becoming increasingly unattractive all over the world.
Bonds (Other)				■		→	Greater returns appear to be available for strategic bond managers, but the additional risks taken to achieve them need to be monitored.
Commodities					■	↑	We are positive on gold, as a geopolitical and central bank play, which works well in low rate environments.
Convertible bonds				■		↑	Convertibles offer a good mix between the defensiveness of bonds and upside of equities. We have reduced, though, to go more into equities.
Equities					■	↑	Equity markets should continue to be supported by solid investment fundamentals and plentiful liquidity despite short-term volatility.
Property (Direct)			■			→	Income, rather than capital growth, should be viewed as the primary reason for investment, given rising bond yields.
Cash				■		↓	We are actively looking for opportunities to deploy cash.

Equity allocation	--	-	=	+	++	Outlook	
Emerging markets					■	↑	Emerging markets have underperformed this year and are not helped by a stronger US dollar. India is still a secular long-term play.
Europe	■					↓	Economic growth still challenged but may have bottomed. European Central Bank (ECB) liquidity infusion will help.
Far East			■			↑	China and global trade are key to the region's outlook. Trade issues are causing concern.
Japan				■		↑	Stock market offers value and sectors of corporate Japan are in good shape but challenged by trade issues.
North America		■				→	Economic and earnings momentum remains superior to other developed regions. We use thematic and global funds to play the US.
Sector specific					■	↑	Healthcare and technology remain long-term themes, although exposure reduced. Recent introduction of listed infrastructure.
UK		■				→	Fundamentals are not compelling but Brexit concerns have eased and valuations are good. We are looking for opportunities to add.

Currency allocation	--	-	=	+	++	Outlook	
US dollar				■		↓	US Federal Reserve rate cuts have not dented US dollar strength, as growth is still higher in the US.
Euro		■				→	Upside could be capped by Brexit concerns and by any escalation of Italian debt concerns.
Sterling	■					→	Sterling's prospects remain heavily dependent upon Brexit but the odds of a no-deal Brexit have fallen significantly.

'=' Weighting within 1% of benchmark. '+ / -' Weighting between 1% to 5% away from benchmark.
'- - / + +' Weighting in excess of 5% away from benchmark.

How can we help?

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