MARKET BULLETIN

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Soldiering on

"Money is a good soldier, and will on," said Falstaff, one of Shakespeare's laziest and best-loved characters. How right he was – as long, that is, as the money is in the right place.

Two years after Falstaff's maiden appearance on the English stage, the first stock market opened in Amsterdam, in 1602. Over the ensuing two centuries, the original listing – the Dutch East India Company – would pay out dividends worth 1,600% of its value.

Unfortunately, many investors struggle to see beyond next week; for those who persist in thinking short term, October was an exceptionally difficult month. The S&P 500 has dipped into negative territory for the year twice in the past fortnight, while volatility on the index jumped to its highest level since March on Monday evening. Indeed, October saw US stocks record their greatest number of negative days in a month since October 2008, in the depths of the financial crisis.

Where US equities led, the world largely followed: Japan's TOPIX struggled through October too, spurring the Bank of Japan to further supportive action. 'Red October', as it was dubbed, also saw the FTSE All-World suffer its worst trading month for six years, on fears over Chinese growth, trade wars and US interest rate rises. Yet there were signs not merely that fears were overwrought, but that the quirks of human psychology were at play. Consider timing: over the course of 2018, the final hour of each day's trading has contributed – on aggregate – 5.1% of losses on the S&P 500; whereas the first hour has contributed an aggregate 0.5% in gains. Rational investing this is not.

By the end of last week, the mood had already changed, as investors were reminded – courtesy of earnings seasons – that companies are still making money, be that in the US, Asia or Europe. The S&P 500, FTSE 100 and Japan's TOPIX all rose over the course of the week. Yet that is often the way.

"Since 1980, we have had 36 market corrections – defined as a decline of 10% or more – averaging a decline of 15.6% and lasting three to four months, but only ten such corrections resulted in bear markets," said Jim Henderson of Aristotle, manager of the St. James's Place North American fund. "Since the financial crisis of 2008, the market has been remarkably devoid of volatility and we are only now getting back to normal. But trying to time the market is futile; markets are generally driven by corporate earnings, which at this stage of the cycle appear healthy."

Indeed, second-quarter US growth came in at 3.5%, completing the US's fastest-growing half-year since 2014. Last week, perhaps with an eye on this week's midterms, Donald Trump tweeted positively about a chat with Xi Jinping, the Chinese president, and stressed the potential for trade deals at the forthcoming G20. The S&P 500 duly rose, led by semiconductor and industrial stocks, which are super-sensitive to US–China trade relations.

Even if the tweet was just so much smoke and mirrors, investors could find other positives. S&P 500 companies are set to report 26% annualised profit growth for the third quarter – the best since 2010. Worries over growth peaking and trade tariffs hitting bottom lines did limit gains, not least for technology stocks. However, Friday's US payrolls report showed 250,000 new jobs and 3.1% wage growth – the highest since 2009. The S&P 500 ended up 1.5%.

Political calls

Yet the gains on the S&P couldn't compare with the rises on Brazil's B3 index last week, following the election of Jair Bolsonaro as president. The hardline candidate, who has praised dictators, hinted at media controls and encouraged police to kill criminal suspects, won a clear majority. It is his economic liberalism that appeals to investors and took Brazil's main index to a new high.

"His party gained more presence in the National Congress, but we are yet to see if it translates into better policy-making," said Polina Kurdyavko of BlueBay, the emerging markets debt manager within the St. James's Place Strategic Income fund. "Overall, we like Brazilian corporate credit, especially distressed assets and merger & acquisition candidates."

Donald Trump was quick to phone the new president with congratulations, seeing in the new leader of South America's largest economy a crucial ally. But he might be forgiven for asking, as Henry Kissinger once did: "Who do I call if I want to speak to

Europe?" Last week an answer grew more distant, as Angela Merkel, after stinging federal elections, said she would not seek re-election as party leader in 2021, adding yet another worry to the EU's list. Although some companies, such as Volkswagen and ING, reported strong results, the eurozone is now growing at its slowest rate in four years – third-quarter growth was a mere 0.2%.

Relations between Rome and Brussels remained fraught last week. Italy's bond yields are at dislocated levels, relative to its debt rating and debt-to-GDP ratio. On Tuesday, the European Commission rejected Italy's draft 2019 budget and gave Rome a three-week deadline to submit a new fiscal plan – or face an 'Excessive Deficit Procedure', which could lead to sanctions.

Budget bliss?

Glancing over to Italy, Philip Hammond might deem himself lucky. Last week's UK Budget was no show-stopper, but the chancellor did announce an end to austerity – much disputed since – and offered some handouts to boot.

"This was an astute political Budget and one which underlined the significant economic improvement that is unfolding here in the UK but which markets, politicians and commentators have, thus far, refused to acknowledge," said Neil Woodford, manager of the St. James's Place UK Equity fund. "It confirms many of the economic assumptions that I have embedded in the portfolio strategy."

A few of the new measures could be felt on markets, but not many.

"It was a relatively bland affair – there was something of a relief bounce for gambling stocks on news that the gambling levy increase would be less than expected, and housebuilders benefited from the 'Help to Buy' scheme being extended to 2023," said Nick Purves of RWC Partners, manager of the St. James's Place Equity Income fund.

One significant measure was a tax on major technology platforms, such as Google, Amazon and Facebook. Yet while perhaps a useful revenue-raiser and popular with voters, the measure's business impact may be marginal.

"Our long-term valuations already incorporate these companies ultimately paying tax broadly in line with the typical rates in geographies where these new measures are being introduced – and the announcement itself came as no surprise," said Hamish Douglass of Magellan Asset Management, manager of the St. James's Place International Equity fund. "Given the low percentage of these taxes, the impact is low."

The chancellor did spend a £68 billion windfall he received from improved tax receipts to deliver the largest discretionary fiscal giveaway since 2010. Interestingly, part of the bounty comes from a significant upgrade in the estimated pension freedoms tax haul for this year. The Office for Budget Responsibility's fiscal outlook reveals that the Treasury will net an extra £400 million as a result of people paying tax on their pension withdrawals, bringing the total take to £1.3 billion in 2018/19.

Fortunately for higher earners, pensions tax relief was left well alone, and there was some further good news for the UK's retirement savers. Budget notes confirmed an additional rise in the lifetime allowance from next April, meaning that many individuals will be able to withdraw a little more from their pots before being hit with a 55% tax penalty.

Aristotle, BlueBay, Magellan, RWC and Woodford are fund managers for St. James's Place.

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