FACETOLOGY

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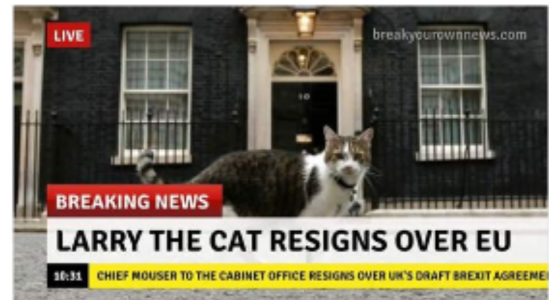
Looking past the headlines



Theresa May's Brexit breakthrough has got everyone in the political world excited - everyone except Larry the cat. The world's media has descended on Downing Street, but that didn't put Larry off his daily routine.

Brexit insight courtesy of the Belfast Telegraph 14th November.

For those glued to the media, it was a week of top drawer political drama with cabinet resignations aplenty in addition to the usual Bexit/EU shenanigans and anything to do with President Trump. So far, so bad. But what, if anything, should your long-term investor be doing in the middle of this whirlwind of news?

In the short-term, a glance at the chart of the UK stock market index isn't particularly inspiring. It is at 7,000, which is exactly where it was a month ago. It's hard to spot any direct impact from this week's negative headlines. In fact, despite all the doom and gloom, it has done marginally better than the US stock market index where the economy is ticking along splendidly. US unemployment has fallen to a 50-year low of 3.7%, GDP forecasts have been revised up to 3.5% and the corporate earnings season is another one of better-than-expected profits. The UK economy is in reasonable shape but nothing by comparison. Yet the US stock market suffered its biggest monthly loss this year.

The financial press may point to a little recent Sterling weakness explain this steadfast resilience of Britain's biggest companies. And why not? Over 60% of the UK stock market company revenues are in foreign currency, by far the majority of which is in US dollars. Relatively speaking, UK stocks look cheap compared to their US counterparts.

However, if one looks back only two years, the reason becomes a little clearer. The US stock market has risen over 23% compared to the UK barely moving a step, up only 3%. Other developed markets have also lagged significantly. The US has been the stand out winner due to a combination of one-off factors, such as tax cuts under President Trump, and because the US is about 2-3 years ahead of everyone else in recovering from the Great Financial Crisis in 2008. Even stripping out distorting factors such as the rise in the share prices of already-large companies such as Facebook, Apple, Amazon Netflix and Google (FAANG stocks), the US has been the place to be for some time.

Conventional wisdom six months ago ran along the lines that if global growth, led by the USA, were to continue into 2019 and beyond, then it would only be a matter of time before other stock markets caught up as investors sought opportunities outside the USA. This is a bullish outlook, of course, for it assumes that rising US rates will not, at some point, constrain US growth through higher borrowing costs. Furthermore, is also assumes the strengthening of the US dollar, which inevitably accompanies higher interest rates, will not strain the budgets of those emerging economies who have issued debt in US dollars but must fund their repayment in their local currencies.

Whether the US stock market is expensive, or the rest of the world is cheap is the great question of our time. If we look at the 10-year US Treasury bond yield to gauge the path of future US interest rates, we see that it has risen 0.73% this year to 3.1%. At this level, it is yielding more than the US stock index and has even been higher to 3.26%. This may be justified so long as the growth in the US economy grows fast enough for investors to keep buying equities with the accompanying risk that comes with it.

As far as the UK is concerned, if investors see some clarity on Brexit, the UK large cap stocks will look comparatively cheap, particularly if Sterling does not rally significantly.

Following the last major downturn in October, the EF FACET Balanced Discretionary Portfolio fund ranked 1st of 149 funds over 1 year in the Mixed Investment 20%-60% sector. The EF Cautious fund was not far behind ranked 4th. this performance was due to the cautious positioning of both funds before the downturn in stock markets which had looked increasingly likely as US stocks traded at all-time highs.

We took the view, following the fall, that the weakness represented an opportunity to take profits in some bonds and property investments and to put more cash to work. As a result, the funds now have a higher exposure to equities although the overall positioning is still one of caution with the emphasis being one of wealth preservation for investors in the fund rather than capital growth.

Political events can sometimes be distracting or downright entertaining but, as always, our investment team will maintain the investment discipline which has driven performance to the best in the sector.

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