INVESTMENT REVIEW – January 2020

The year of 2019 ended with fireworks but with bush fires as a possible portent of greater challenges. There was much to celebrate in markets which mostly saw exceptional returns over the year and a positive month to end it. Investor confidence grew with the moves by the US and China to reach a compromise on their trade dispute, as well as a decisive outcome to the election in the UK.

Domestically-oriented elements of the UK market rallied sharply in relief at the sizeable Conservative victory and Sterling saw a small further rise, although the size of the Tory majority in parliament has already raised concerns that not only will the government get Brexit done but it will risk leaving with no deal if trade discussions are inconclusive by the current due date for departure of 31st December. The Queen's Speech included plans for increased spending on education and infrastructure as well as some support for working families, as the Tories play to the One Nation theme and look to confirm their position as the natural party of government, if not so outside England. A fiscal boost as austerity ends will be important to stimulate a mildly moribund economy as will private investment which has been impacted by the uncertainty of recent years; this might bring a boost to the productivity of the country too. For now the Bank of England has opted to keep interest rates as they are, while Andrew Bailey was chosen as its new governor to replace Mark Carney in March.

The Federal Reserve in the US has said that its moves to cut interest rates should be seen as part of a new strategy until there were a significant increase in inflation, rather than as a temporary measure to insure against slower growth. The focus there will be on the build-up to the presidential elections due in November if also day-to-day on the Twitter feed of Donald Trump, who was formally impeached in the month. While he has threatened sanctions against France and the wider European Union he has supported a compromise of sorts with China over their trade war, which should see a first-phase deal done in the White House on 15th January: the US has agreed not to impose duties on a further $156bn of Chinese goods and to halve the tariff rate on $120bn of imports that it imposed in September. A strong economy has usually been key to prospects of re-election in the US, as elsewhere, and such a deal would help to restore confidence as well as investment in the manufacturing sector; for now there is no shortage of confidence among consumers, which will have been helped by strong stock market returns.

The Chinese authorities would also benefit from an easing in the pressures that US tariffs have placed on an economy that was already showing a lower level of growth as it (and the work force) matured. The other trade dispute in the region, between Japan and South Korea, has also eased although the deeply-ingrained issues over Japan's imperial past are unlikely to fade, especially if Prime Minister Shinzo Abe pursues a more aggressive approach. For now his government has provided a further economic stimulus of ¥13.2trn (£90bn) to offset the typhoon damage in October and to boost digital technology in the country; the economy is expected to have barely grown in the last quarter of 2019 even if the latest hike from 8% to 10% in the rate of VAT has had a lower impact on retail demand than was feared.

In Continental Europe there remains pressure on car companies which might face substantial fines if they do not sell enough electric vehicles to offset the sales of more polluting versions. As in the UK central bank policy continues as before and there is an increased expectation of a fiscal stimulus, even if (or perhaps because) many governments have lacked a clear mandate or faced considerable dissent.

It should be a fascinating year, when fiscal and *flygskam* (flight shame) may prove as common words as Brexit, impeachment and interest rates. Markets may yet maintain their momentum if corporate profits prove resilient and if political or geopolitical problems do not preclude them. There remain some considerable challenges in debt burdens, inequality, weather patterns, mortality and the like while by definition this drawn-out economic cycle is closer to its end, even if it is not at all clear when that will be. It will be a year of 2020 vision, if in hindsight.

In the UK the FTSE 100 rose by 2.7% over December to end at a level of 7542 to make a gain for the year of 12.1%. The mid-sized companies in the FTSE 250 index benefitted from a boost on the election result with a gain of 5.2% over the month making for a striking 25% for the year, as did the FTSE SmallCap index which rose 5.9% in the month and 14.9% for the year. The FTSE All-Share was 3.3% higher for the month and 14.2% for the year, although it is flat on a two-year basis excluding income. The FTSE AIM All-Share made 3.9% in December.

In the US the S&P 500 rose by 2.9% in the month to reach fresh all-time highs and to make an annual return of 28.9%, boosted by the large technology shares which helped the NASDAQ index to gain 3.5% in the month and 35.2% in the year. The more concentrated Dow Jones Industrial lagged a little with a rise of 1.7% in December and 22.3% in 2019, while smaller companies, as represented by the Russell 2000 index, made 2.7% and 23.7% respectively.

In Europe the EURO STOXX 50 rose by 1.1% in the month, with the German market barely changed, which made for a significant gain of 24.8% over the year, while the Euromoney index of smaller companies made 2.5% and 17.6% respectively. In Japan the Nikkei 225 also had a relatively subdued month with a gain of 1.6% although also a strong return for the year at 18.6%. The MSCI Emerging Markets index in US$ was notably higher in December when its gain of 7.2% accounted for almost half of the 15.4% return for the year; the Shanghai index rallied on the trade news and Brazil rose. The MSCI Frontier Markets index made a decent gain of 4.3% in the month (although the Vietnamese index was down again), while the return for the year was 13.5%.

In the bond markets the UK 10-year gilt yield rose further in the period from 0.7% to 0.82%, if still down on the level of 1.28% at the start of the year. The total return for the FTSE Gilts All Stocks index was -1.3% in the month if still a respectable 6.9% for the year. In the US 10-year yields also moved higher from 1.78% to 1.92% and the inversion of the yield curve seems a distant memory, while in Germany they were again a little less negative at a level of -0.19%. In the month there were positive returns from high yield and emerging market debt while over the year all the main bond markets rose.

Sterling was stronger in the month, gaining 2.6% against the US$ to close at a rate of $1.33:£ and up 0.7% against the euro at €1.18:£ although it weakened from post-election highs. The price of gold rose by 3.6% in the month to end at $1517 per troy ounce to make a good gain for the year of 18.3%. The price of Brent oil was 8.3% higher over the month at $66 per barrel, which made for a rise of 25% in the year. Major metal prices and the main agricultural commodities also rose in December. The Vix index gauge of expected volatility rose in December if nearly halving over the course of 2019.

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