TPO Investment Market Update

American Roller coaster

10 September 2020

The dominating news in markets over the last month has been the huge volatility of the US stock market. Over the last month the S&P 100 has seen an increase of 8% (fuelled largely by large tech stocks) and since the 2nd September, it has lost 8% (mainly the same large tech stocks) putting investors back to where they were. Having said that, we feel it would be a mistake to liken this to the great tech crash of 2000. Today's tech stocks have far more fundamental strength and most are here to stay.

This is an uncomfortable experience for investors who have focused on the US and it probably feels more like casino investing rather than long term strategy. More than ever, the importance of diversified investing is highlighted by this experience. In this environment it takes a brave person to make a serious call on next month's winners and losers. Correct asset allocation and efficient diversification is the only sensible way forward.

Economic and Political Data

The US

We saw volatility return to markets last week with all major US equity indices selling off. The S&P 500 and Nasdaq are down over 3% and 5% respectively since Wednesday.

Putting to one side the trading activities of SoftBank who were unmasked as the 'Nasdaq whale', there was no obvious catalyst that caused the sell-off. This leads to the conclusion that it was a case of investors exiting positions which were seen to be trading at excessively high valuations and have seen stellar growth in recent months.

On the economic data front, we saw the unemployment rate fall more than expected with the rate dropping to 8.4% in August vs 10.2% reading in July. Furthermore, it has been reported that 48% of the jobs lost during March and April have been recovered in the past four months.
In a further escalation to US-China relations, Chinese state media suggested that the Government could sell some of its holdings in US treasuries. China being the US's second largest creditor behind Japan and is estimated to hold just over $1tn in US Treasuries.

The strength of the US Dollar has waned in recent times and with yields at historic lows it does add credence to this potential scenario, however it doesn't detract from that it would be the 'nuclear option' and have a negative impact on both the US and China. In part because a vicious feedback loop that would ensue where the Dollar would fall (following a large sale of US Treasuries) and the Chinese Yuan which is not a free floating currency and managed against the Dollar would have to be artificially weakened through the potential sale of more US Treasuries.

Europe

Europe was buoyed by news that the World's largest trading bloc was showing signs of recovery. That said whilst domestic activity is increasing with global peers still contending with the fallout of coronavirus a headwind to future recovery will persist.

We also saw France announce that they would continue with its furlough scheme if economic conditions worsened. This coming at a key junction where Governments must now decide whether to continue or remove furlough schemes which by all accounts have reduced the level of redundancies due to coronavirus.

Finally, we saw Germany issue its first ever green bond which as expected was wildly oversubscribed – the €6bn 10-year issuance attracted over €33bn worth of bids.

We urge you to stay safe and remember that your TPO advisers are here to guide you through this storm. If you have any questions or concerns, please do get in touch.

The value of investments can fall as well as rise. You may not get back what you invest.

The bonds were unique in that they were structured to provide the investor with the ability to swap the green bond for an otherwise comparable conventional bond which does help mitigate liquidity concerns for the fledgling green bond market.

The UK

The end of the year is fast approaching and with it the end of the transition period for the UK to leave the EU. Whilst some would suggest speculation is folly at this stage, the markets have taken a bearish view on Sterling with the expectance that the Bank of England will have to cut interest rates as a result of a no deal Brexit.

In the interim though the outlook for the UK has improved with an increase in demand being seen across sectors as lockdown restrictions are (somewhat) lifted. As you would expect the largest relative increases have been seen in the retail sector which has been a key beneficiary of the 'Eat Out to Help Out' scheme and the housing sector which saw renewed growth following the reduction in stamp duty.

This occurrence is not UK centric and has been seen across the world where countries have reopened following lockdown. As such we can expect that demand will taper but being cognisant of that schools are reopening and more people are in turn returning to offices, so there is potential further increases to be seen in the short term.

China

The Chinese economy recovery story continues with strong domestic demand being recorded and that the manufacturing sector remains firmly in the expansionary territory. This also coinciding with a 9.5% increase in exports during August which is the largest monthly increase seen this year.

We saw Chen Yulu, the Deputy Governor of the PBOC signal China's desire to offer a 'more open financial system' to attract foreign investors. Whilst this is seen as a move to temper the impact of US Trade sanctions there is a precedent following the introduction of the 'Stock Connect Program' which allows foreign investors to invest in China. This program has been welcomed in the investment community and as a result we now see overseas investors owning 4.6% of the shares listed on the A-Share index.

When a technology selloff is not a dotcom bubble

The top five technology stocks in the S&P 500 (Microsoft, Apple, Amazon, Alphabet and Facebook) have in recent times made up over 20% of the index and this has been heralded that these stocks are too expensive and a correction will happen soon.

This event has now come to fruition with a wide spread sell-off of the Nasdaq in part driven by material price falls for Apple, Facebook and Microsoft. Parallels have since been drawn with that of the dot-com era where we saw a precipitous expansion and fall in the share prices of technology companies.

Firstly, it's important to note that the extended valuations we have seen are a product over several years which is in comparison with the exuberant (and comparably short lived) run up in technology stocks during the dot-com bubble.

Fundamentally as well we see the current batch of technology companies having more robust balance sheets, persistent levels of free cash flow and possessing high barriers to entry. It is the latter point which is important because during the dot-com bubble we saw a number of new entrants to the market which simply had to have the word 'data' or 'online' in their company name to attract record capital inflows from investors.

The example of 'Geeknet' (formerly known as 'VA Linux Systems') comes to mind where the company offered shares at $30 at IPO but by the market close the shares were trading at $239 (a 698% increase). Fast forward twelve months and the shares were trading at just over $8.

We must also consider that technology is integrated into every area of our daily lives now and not confined to certain areas like we saw at the turn of the century. This will allow for technology companies to continue to be the key drivers and beneficiaries of structural disruptions like artificial intelligence and electric vehicles, so the valuations we assign to these companies must be reflective of this fact.

This is not to say you should not be cognisant of valuations but it's important to remember the context especially when we are seeing extreme movements in markets.

TPO Portfolios

Because of our diversification our Managed portfolios have experienced a relatively flat month without the huge volatility of the US, or, indeed, the slight downward movement of the top 100 companies in the UK. Over the past five year period the top 100 UK Companies are up 17.9% and our Preferred Portfolio II up 29.8%. However, it is worth noting that over a one year period these top 100 UK companies are down 15.7% whereas our Preferred Portfolio II is down only 0.66. This is largely attributable to diversification (both of asset class and geographical exposure) and the fact that many of our underlying equity fund managers were active at the beginning of the pandemic, disposing of "exposed" sectors and rotating into stronger areas.