Market Update

Initial Reaction
12th October 2018

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October has got off to an awkward start for financial markets and this week has seen some quite significant moves. There were losses across most global equity markets, not least in the technology heavy (think Facebook and Apple) US NASDAQ index which dropped more than 4% on Wednesday, its biggest one day fall since June 2016. This was joined by losses across Asian and European bourses. In sterling terms the UK's stock market, as measured by the FTSE All Share index, has fallen by nearly 7% this month (as at 11th October 2018), with other areas, such as emerging markets, off a bit more than this.

A myriad of reasons have been touted for these moves, the most prevalent of which has been that markets are readjusting to a world of higher US interest rates, which has led to yields on US government debt rising (therefore prices falling) and spooking equity markets. This has affected stock markets not least because it can lead to an increase in a company's cost of debt but also because government bond yields are used by investors in their calculations to value companies; so in essence if these rise a company's value could fall. Elsewhere, ongoing global trade disputes are making both companies and investors nervous, and there have been some concerns that global growth this year may be not as strong as expected.

Firstly, we would say that moves such as these should not be too surprising at this stage of the economic cycle and that it is important to place these falls in a longer term context. For example, the world's stock markets in aggregate (as measured by the MSCI AC World index) have returned c.50% and c.70% over three and five years respectively (as at 11/10/2018); a period which includes these past few days. As such market corrections of this scale, whilst uncomfortable, are a natural part of investing and should be expected at times. Whilst they can become more frequent they can also be fairly short-lived. As we pen this note Asian and European stock markets are back in positive territory today, and it is likely the US will also open up as well. Secondly, even though global economic growth expectations have been marginally toned down recently, it is still expected to be firmly positive (the International Monetary Fund forecasts growth to be 3.7% this year) and the world's most significant economies, especially the US, are in good shape.

There are no shortage of potential risks out there, from rising protectionism and trade frictions, the ongoing saga that is Brexit and the slow end of what has been a very accommodative monetary policy backdrop in the developed world (chiefly low interest rates), all of which help validate our cautious positioning in portfolios. However, we see limited indications that a global recession is on the immediate horizon, which would be the main cause of us becoming very concerned and lead to us really battening down the hatches.

It is certainly becoming a more difficult time to be an investor, the latter stages of the economic cycle tend to be, and whilst most markets are now unfortunately in negative territory for the year, it is, in our opinion, not a time to be throwing in the towel. However, it is indicative as to what could be expected in the times to come and we would suggest that investors should perhaps not expect future returns to be as linear or as high as they have been in recent years.

Source: FE Analytics as at 11th October 2018.

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