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Market Update

JANUARY | 2019

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INVESTMENT SERVICES

"Britain can be cancelled, top EU lawyer says" - so blundered a headline writer on CNN's website. However, It sometimes feels like it. A divided nation, a crippled Government and a Leader of the Opposition who transparently covets investors' hard earned savings. It is perhaps not a surprise therefore that this has been the worst year for UK financial markets since the Great Recession in 2008 and the FTSE 100 is back down to a level first seen in 1999. Over the quarter the FTSE All Share index slumped by 10% and this unpleasant period has helped mean that very few investors made money over 2018 from financial markets.

Perversely, the principal cause of the markets' woes were not UK related but more global in nature, and in particular, American. Stock markets began the quarter on a weak footing as they digested the implications of rising US interest rates, only for the falls to intensify towards the end of the quarter as concerns emerged about the sustainability of economic growth. In fact, Wall Street suffered its weakest Christmas trading period on record and the world index suffered similar losses to the FTSE All Share index. Profits growth over 2018 has been exceptionally strong and investors had been counting on the trend continuing through 2019. As the pace of economic growth falters, these projections are being reassessed.

Stock markets slump

Nevertheless the current market turmoil has left equity prices at more interesting levels if the current level of corporate profitability can be sustained. Investors have been much more circumspect about UK shares, understandably so given Brexit and the shadow cast by Corbyn in the background. The UK stockmarket has fallen at the same pace as global markets this quarter and UK shares are now trading at below average prices, both relative to other markets and to their own history. This may potentially leave them attractive.

However crucial to this question is whether or not economies are entering a recession. If growth turns negative, profits will be shattered. Thankfully we see little evidence to support this notion, although we cannot ignore the possibility entirely. However, experience tells us that a sudden change in expectations such as we have just experienced, tends to have a fairly immediate short term impact on profits. This won't help what are already frayed investor nerves and our instincts warn us that markets may still weaken further from here.

This does not mean that risks have gone away. Brexit remains an unknowable, the trade war needs to be kept under control and the interest rate outlook is uncertain. An emerging issue is the US budget deficit. The recent massive tax cuts have not been matched by spending cuts and the shortfall is being made up by ever more borrowing. However, the recent market falls combined with the strong profits growth seen over 2018 has left stockmarkets much more attractively valued than has been the case recently. The risks for investors have not gone away, they never do. However the fall in valuations has made the potential long term returns more attractive and this is encouraging if we can look through the uncomfortable short term market noise.

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