BREWIN DOLPHIN

Markets in a Minute

11 August 2020

Global markets push higher on growing signs of recovery

Global equity markets largely pushed higher this week on positive economic data. The Nasdaq hit a new record high, as did the gold price, while the S&P500 is now less than 1% below its February peak of 3386. Global purchasing managers' indices, which are used as a way of measuring how businesses are performing, showed improvements in most regions suggesting we are on the road to recovery.

Last week's markets performance*

- FTSE100: +2.27%
- S&P500: +2.45%
- Dow: +3.8%
- Nasdaq: +2.47%
- Dax: +2.9%
- Hang Seng: -0.25%
- Shanghai Composite: +1.33%
- Nikkei: -4.4%**

** Data for the week to close of business on 7 August 2020*

A positive start to the week

Markets started the week mainly higher on news of the US stimulus executive order. The FTSE100 gained 0.3% while markets across Europe also closed up. In the US, the Dow and S&P500 both closed up, but the Nasdaq closed down by 0.4% pulling back from the record highs of last week. In early trading on Tuesday, equities in the UK and Europe were heading up.

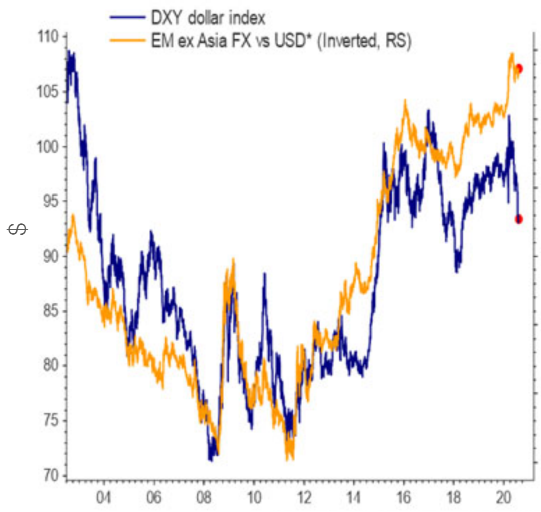
US Nonfarm payrolls

The monthly survey of the US labour market came in 19% ahead of forecasts which amounts to 280,000 unexpectedly employed Americans. The particularly good news here was that there was little change in non-temporary (i.e. permanent) layoffs, which is a big improvement given that they have been rising consistently for the past two months. The unemployment rate fell from 11.1% to 10.2%, but that reflects people giving up on finding a job rather than finding work.

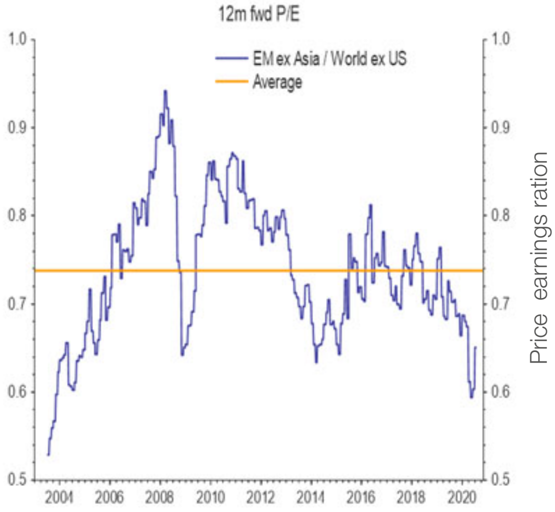
US stimulus

Donald Trump signed an executive order authorising the payment of $400 a week in extra unemployment payments, down from the $600 a week that has been paid since March. He signed the order after Republicans and Democrats in Congress were unable to reach a deal. However, the order requires states to contribute 25% of the costs, which many states say they simply cannot afford and do not intend to pay. And the President's order would require entirely new administrative systems to be set up, which could take weeks if not months. At best it looks unlikely that anybody will receive any payments before September. The money to pay for it, taken from the country's disaster relief fund, is only enough to keep the programme going for another four or five weeks, according to US reports. It may have bought a little time but it seems inevitable that Congress will need to agree a longer-lasting solution.

EM ex Asia is a cheap way to position for further dollar weakness



Source: Refinitiv Datastream *equity market cap weighted



Source: Refinitiv Datastream

Emerging markets ex Asia. Growth to come…

In the week, we examined the case for emerging markets ex Asia, which has performed disappointingly. Under normal circumstances, emerging markets would benefit from rising commodity prices and a weak dollar, both of which have been pronounced recent trends. But high rates of Covid infections are weighing on sentiment. Therefore, once the Covid numbers begin to decline we expect to see the value in this sector gradually released.

Changes to our asset allocation

The asset allocation committee increased exposure to equities as the evidence grows that we are at the foothills of a new economic expansion. As such, the pitiful returns offered by bonds and cash are deeply unappealing. We also shuffled our geographical investment allocation. We are positive on the prospects for the US but trimmed back the underperforming UK, which seems weighed down by an unfavourable mix of sectors such as banks. We increased exposure to Europe which should benefit from improving economic activity, a strengthening euro, and more exposure to the increasing economic activity in China. We have also turned more positive on the prospects for Asia, where the better domestic growth environment, proliferation of strong growth companies and scope for rallying currencies should all support growth.

WeChat ban ramps up tensions between US and China

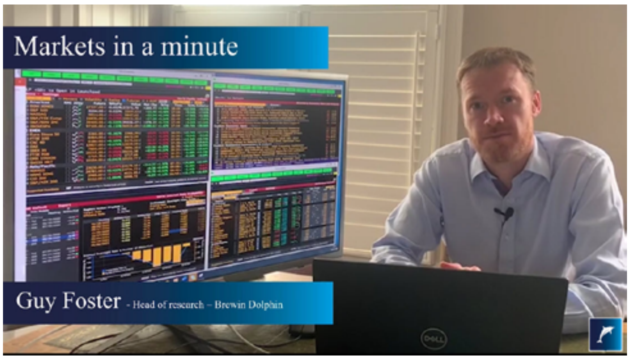
The decision last week by Donald Trump to ban American firms from doing business with WeChat, the Chinese app, is more serious than it seems. Although WeChat is primarily a social media app, it is also used instead of email because it is much more convenient. Crucially, it also has banking functionality which means businesses can use it to facilitate transactions. The ban could make it harder for American companies to do business with Chinese firms and it will certainly be seen as a major escalation in the tit-for-tat cold war between the two countries.

Banking woes

Banks are having a tough time as you might expect at this stage in the economic cycle, having to put aside billions in provisions for bad debts. The S&P500 is up 3% so far this year, but the banking sector of the S&P500 is 35% down. But banks in the UK are facing some unique challenges. The Covid response saw a predictable cut in interest rates and increase in QE, but it also saw new policies which attempted to send relief to where it is most needed. For example, the UK government introduced the Coronavirus Business Interruption Loan Scheme (CBILS) in which 80% of each loan was guaranteed by the government. The remaining 20% however was still a significant risk to banks which were already facing the probability of credit losses on their existing lending. But when banks attempted to seek personal guarantees for their share of the risk there was a backlash from borrowers and accusations of profiteering.

Since then the Bounce Back Loan Scheme (BBLS) has avoided the thorny issue of risk sharing but the government continues to use the banking system as an instrument for the delivery of centrally manufactured policy tools, rather than allow them to be the efficient allocators of entrepreneurial capital that they are supposed to be.

That leaves us wondering about the investment potential of the sector given the lines between banks and the state are becoming more blurred. If retail banks are now the lenders of last resort, even if only from an administrative perspective, then that adds an additional burden at a time when credit risks begin crystallising and interest margins are coming under more pressure. The prohibition on dividends, even those already declared, further blurs the line between the state and banks. We remain positive on Barclays because it has fallen back in price significantly and because it has a profitable investment banking division that insulates it from the ups and downs of the high street.



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